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

FORM 10-K

(Mark one)

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

For the fiscal year ended: September 30, 2005

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: 0-17972

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

Delaware	41-1532464
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

11001 Bren Road East
Minnetonka, Minnesota 55343
(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common stock, $.01 par value
(Title of each class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ☑ No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No ☑

The aggregate market value of voting stock held by non-affiliates of the Registrant as of the last business day of the Registrant's most recently completed second fiscal quarter was $308,757,212, based on a closing price of $13.72 per common share as reported on the National Association of Securities Dealers Automated Quotation System National Market System.

Shares of common stock outstanding as of November 21, 2005: 22,845,022

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DOCUMENTS INCORPORATED BY REFERENCE

The following table shows, except as otherwise noted, the location of information required in this Form 10-K, in the Registrant's Annual Report to Stockholders for the year ended September 30, 2005 and Proxy Statement for the Registrant's Annual Meeting of Stockholders scheduled for January 18, 2006, a definitive copy of which will be filed on or about December 7, 2005. All such information set forth below under the heading "Page/Reference" is incorporated herein by reference, or included in this Form 10-K on the pages indicated.

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PART I

ITEM 1. BUSINESS

COMPANY OVERVIEW

Digi International Inc. (Digi or the Company) was formed in 1985 as a Minnesota corporation and reorganized as a Delaware corporation in 1989 in conjunction with its initial public offering. The common stock of Digi is traded on the NASDAQ National Market under the symbol DGII. The Company has its worldwide headquarters in Minnetonka, Minnesota, with regional sales and engineering offices throughout North America, Europe, and Asia Pacific.

Digi's first products were box and board-level serial port adapters (sold under the DigiBoard brand) that were used to directly connect multiple peripherals, such as standalone computer terminals, to personal computer servers or a host computer system. During the 1990's, next generation technologies, most notably Ethernet, emerged to provide the connectivity infrastructure for businesses. This trend began in the head and branch offices of businesses and in the late 1990's began to extend to the factory, retail stores, restaurants, and many other environments such as medical, traffic control, and building controls. During the same time, the semiconductor industry was also advancing rapidly. Complete systems were being built on single integrated circuits (chips). These chips, as part of a box or board product, could be used to build a network interface for virtually any device for which network connectivity was required. Digi recognized the developing opportunities for device connectivity and in early 2000 implemented a strategy to leverage the brand strength that it had established with the DigiBoard product line by organically developing or acquiring next-generation connectivity products and technologies that would extend the value of the brand into an array of commercial application markets.

- In October 2000, Digi acquired privately held Inside Out Networks Inc. (Inside Out Networks), a developer and marketer of "out of the box" external data connection technologies that utilize Universal Serial Bus (USB).
- In June 2001, Digi acquired INXTECH, a French designer and manufacturer of Ethernet connectivity solutions sold under the Xcell technology brand. This acquisition provided technology and market knowledge to accelerate Digi's introduction of its device server product line. Device servers are intelligent, easy-to-use network devices that convert serial data into network data.
- In February 2002, Digi acquired NetSilicon, Inc. (NetSilicon), a developer and marketer of network attached processors and device connectivity software. NetSilicon-branded advanced microprocessors and software allow customers to build intelligent, network-enabled solutions for manufacturers, mostly original equipment manufacturers (OEMs). The acquisition of NetSilicon complemented Digi's device connectivity strategy by allowing the Company to transition from external connectivity solutions to embedded networking solutions and to incorporate higher levels of networking functionality. NetSilicon also recognized the value of providing complete networking solutions as common networking protocols such as Ethernet and the Internet Protocol (IP) emerged. In order to provide a common networking environment, manufacturers need to integrate multiple hardware and software sub-systems with networking functionality. Adding network functionality with components from multiple sources requires the engineering integration of these components, including a microprocessor, an Ethernet interface, a real-time operating system, a TCP/IP stack, software drivers, and other complex components, all of which must be integrated to enable full networking functionality. These proprietary solutions have historically not been cost effective and employed rudimentary connectivity that could not routinely be upgraded. NetSilicon addressed these networking issues by developing integrated hardware and software solutions for manufacturers who want to build network-ready products. Their solutions fully integrate network-enabled microprocessors (specialized computer chips), an operating

ITEM 1. BUSINESS (CONTINUED)

COMPANY OVERVIEW (CONTINUED)

system, networking software, and development tools. The fully integrated chips and software tools (sold under the Net+Works® and Net+ARM® brands) are “embedded” by customers into their intelligent electronic devices, allowing their products to connect to the network. Once connected, these products can be managed, serviced, and accessed from anywhere, and are designed to provide customers with a fully integrated, easy-to-use, standards-based solution that lowers development risk, accelerates time-to-market, and reduces the total cost of ownership.

- Effective April 1, 2005, Digi acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (FS Forth), leading providers of embedded modules based on NET+ARM® and other architectures with supporting embedded software, enhancing Digi’s embedded product portfolio. The acquisition also added expertise in a wide range of popular operating systems such as Linux, Windows CE and VxWorks®. Combined with Digi’s NET+ARM® family of microprocessors and the NET+Works® complete development environment, the acquired business was complementary to Digi’s broad range of ARM-based embedded networking products and enables customers to migrate seamlessly from core module to chip, protecting their research and development investments.

- In May 2005, Digi acquired Rabbit Semiconductor Inc. (formerly Z-World™, Inc. and hereinafter referred to as Rabbit). Rabbit manufactures the Rabbit™ line of microprocessors and microprocessor-based core modules and Z-World single board computers. Rabbit’s products allow for quick-to-market solutions for a variety of systems and devices that require network connectivity. Rabbit’s products are primarily applied to endpoint devices and applications such as sensors, meters, vending machines, card readers, and scales. Similar to Digi, Rabbit bundles hardware and software together, creating an engineer-friendly development environment. Since Digi products are typically used in integration point devices such as access control systems, alarm system controllers, and other more complex endpoint devices such as kiosks, industrial printers, radio frequency identification (RFID) readers, and security cameras, the combination of the two competencies provides customers a partner who can supply easy-to-integrate embedded networking solutions for both of these needs.

Digi continues to develop and provide innovative connectivity solutions to its customers that have a common core technology base. Core technology is being migrated across product lines to provide additional functionality for customers, allowing them to get to market with network-enabled devices faster to improve their return on capital spending investments. Digi has positioned itself in the growing market of integrated hardware and software connectivity solutions to network-enable the coming generation of intelligent devices in commercial applications. The Digi objective is to allow customers the ability to seamlessly migrate through various connectivity technologies without making major changes to their software applications, thus making device networking easy. Digi offers solutions that enable a virtually unlimited number of devices or users to be connected to local area networks (LANs), multi-user systems and the internet. These solutions allow customers to automatically collect, track, measure, monitor and control the critical data they need to gain a competitive advantage and build their businesses.

Digi operates in two reportable business segments: Connectivity Solutions and Device Networking Solutions. These segments, along with related geographic information, are more fully described in Note 6 to the Company’s Consolidated Financial Statements. The Connectivity Solutions segment includes multi-port serial adaptors, terminal servers, USB connected products and cellular products which provide connectivity solutions that are external to the devices they support. The Company sells its Connectivity Solutions products globally through distributors, systems integrators, solution providers, and direct marketers as well as direct to strategic OEMs, government and commercial partners.

ITEM 1. BUSINESS (CONTINUED)

COMPANY OVERVIEW (CONTINUED)

The Device Networking Solutions segment includes external and embedded device servers, integrated microprocessors, networking software, core modules and single board computers which may be embedded in the devices themselves. Revenues from this segment are derived primarily from the sale of products to OEM customers which integrate products into larger solutions or systems and to a lesser extent from the sale of software licenses, fees associated with technical support, training and engineering services and royalties.

As Digi continues to work toward its objective of seamless migration for its customers through connectivity technologies, with a goal of maintaining its leadership position in commercial grade device networking, the segments described above are being reevaluated. This evaluation results from the migration of core technology across product lines, as well as changes in the Company's infrastructure that affects the way management views and assesses its business. The Company is considering a change to a single reporting segment in the first quarter of fiscal 2006 as a result of this reevaluation.

APPLICATION MARKETS AND PRODUCTS

Digi believes it is a worldwide leader in commercial grade device connectivity, through network-enabling devices in stores, factories, office buildings, banks, gas stations, oil rigs, hospitals, and many other vertical environments. The Company's products are compatible with many computing platforms, including IBM, Hewlett Packard and Sun Microsystems, as well as popular operating systems, such as Microsoft Windows NT/98/2000/XP/2003/CE, Linux, and Unix.

The Company has sales offices located throughout North America, Europe and Asia Pacific. Digi products are available through approximately 180 distributors in more than 65 countries.

The application markets where these products are most prominently used are industrial automation, retail/point-of-sale, building automation/security, medical/healthcare, out-of-band management, and office networking. The Company's product lines are its multi-port serial adapters, network connected products (device servers and terminal servers), USB connected products, cellular products, and embedded networking products, including microprocessors, embedded modules, core modules and single-board computers, and networking software.

Application Markets

Industrial Automation – Digi offers solutions for the common challenges found in virtually every manufacturing facility today. These challenges include productivity improvements, inventory management and quality control. Digi provides solutions for attaching essential devices, including process and quality control equipment, pump controllers, bar-code readers/scanners, scales and weighing stations, printers, machine vision systems, programmable logic controllers (PLCs) and many other types of manufacturing equipment.

Retail/Point-of-Sale (POS) – Digi solutions solve the challenges associated with enabling POS devices to effectively share information across the network. Digi solutions can be used to easily connect network devices like card swipe readers, bar-code scanners, scales, receipt printers, cash register display poles, information displays and RFID readers.

Building Automation/Security – Digi products automate and control buildings' heating, ventilation and air conditioning (HVAC) and security systems, and solve the problem of stand-alone control systems that are unable to talk to each other and share important data. Digi solutions can be used to centrally manage equipment and improve the comfort, safety and productivity of building occupants.

ITEM 1. BUSINESS (CONTINUED)

APPLICATION MARKETS AND PRODUCTS (CONTINUED)

Medical/Healthcare – Digi solutions network-enable medical equipment and devices to receive, monitor and access patient information quickly, easily, and accurately, utilizing the hospital's existing Ethernet network to improve patient care and reduce operating costs. Examples include blood analyzers, infusion pumps, ventilators and other point of care and diagnostic equipment.

Out-of-Band Management – Digi's out-of-band management solutions enable immediate response when a network collapses or in other critical situations, providing connectivity when the primary network is down and eliminating costly travel to remote sites.

Office Networking – Each business day billions of images are created, moved and then output in some form over networks and the internet in a process called Image Communication. This demanding process has driven the need for a new generation of network attached devices to manage the ever increasing load of network media. Digi provides the core solutions for connecting, enabling and managing this process for office, industrial and POS printers, network cameras, information displays, network projectors and multifunction printers/copiers.

Products

Digi continues to innovate and provide highly differentiated products to support the long-term growth trend to connect devices to networks in order to bring more intelligence to devices in the many application markets described above.

Multi-Port Serial Adapters

The Company is a market leader in this product category and offers one of the most comprehensive multi-port serial adapter product families. The Company's products support a wide range of operating systems, port-densities, bus types, expansion options, and applications.

As Ethernet connections extend beyond current applications, the multi-port serial adapter products are gradually transitioning to network-attached and/or USB-attached devices. While the Company will continue to fully support this mature product line, it has strengthened its product offering to meet customer needs and is working to seamlessly transition customers to newer technologies.

Network Connected Products

The Company's terminal server and device server product families offer flexible, powerful and easy solutions for providing access to serial devices over Ethernet networks. With a comprehensive offering of one-port through 64-port products, this product family quickly and easily turns a previously isolated device with a serial port into a fully collaborative component of the network. The Company believes that terminal servers and device servers will continue to be an important product category as Ethernet-based serial connections extend beyond their current applications and into new market applications such as building automation, health care, process control and secure console port management on servers, routers, switches, and other network equipment. In 2003, the Company introduced a line of device server products. This was followed by the Digi Connect family of customizable device servers including the Digi Connect SP. The Digi Connect SP is a customizable external box solution for Ethernet enabling an installed base of devices. Early in 2004, the Company introduced the Digi CM Console Server, extending the Company's line of console servers with a secure 48-port series of ports. The Company extended the capability later in the year by adding Automatic Device Recognition, intelligent, state-of-the-art technology that automatically identifies attached equipment to the Digi CM remotely. Digi's CM console servers are compatible with virtually any network equipment with a

ITEM 1. BUSINESS (CONTINUED)

APPLICATION MARKETS AND PRODUCTS (CONTINUED)

serial port including Sun, Cisco, IBM, Hewlett Packard, Unix, Linux and Microsoft Windows Server 2003. In 2005, Digi introduced the industry's most secure 802.11b wireless device server, the new Digi Connect Wi-SP, which becomes the first to feature WPA2 / 802.11i enterprise security. Digi also introduced the Digi ConnectPort™, the industry's first remote networking solution to utilize display and serial over IP technology. The ConnectPort is a network-enabled video display hub that allows standard video displays and other devices to be anywhere on a LAN or other IP network without a locally attached host PC or thin client.

Universal Serial Bus Connected Products

The Company has one of the most comprehensive and sophisticated USB product lines in the industry. Furthermore, the Company's pioneering EPIC software provides seamless transition between legacy software/systems and next generation USB attached devices, supporting feature rich hardware and software flow control signaling. This software provides ease of use and integration while protecting technology investments. In 2003, the Company expanded its offering further to include USB based sensor products and support for powered peripherals. In 2004, the Company introduced the USB Plus Series of products including power management capabilities. This product line simplifies system architecture by eliminating the need for power supply bricks for USB connected products. In 2005, Digi launched its commercial-grade Watchport®/V2 second-generation USB camera, which becomes the ideal for cost-effective remote monitoring applications.

Cellular Products

In 2005, Digi launched its new wireless remote device networking products with the first intelligent high speed GSM EDGE gateway. The Digi Connect WAN GSM became the first gateway to offer a cost effective, diverse alternative to landline data connections by utilizing Cingular's high-speed GSM-based GPRS/EDGE network for network connectivity. This was followed by a CDMA 1xRTT version of the same product for use on CDMA cellular networks like Sprint. Digi also launched the industry's first Serial-to-Wireless gateway using GSM EDGE for connecting remote serial devices via Cingular's high-speed wireless GSM network and CDMA 1xRTT for connecting remote serial devices via Sprint's high-speed CDMA network. These applications add cellular connectivity to allow remote device management for critical functions or hard to reach locations, either on a primary or back-up basis.

Embedded Networking Products

Microprocessors and Development Tools – With the acquisition of NetSilicon in February 2002, the Company entered the embedded system market and now designs and manufactures integrated network centric silicon-based solutions for manufacturers who want to build intelligence and network connectivity into their products. The platforms integrate high performance microprocessors and advanced networking software to provide fully integrated networking solutions. In 2004, the Company released to full production the NS9775 and NS9750 microprocessors and the Net+Works® 6.1 development tools and networking software suite. With its high degree of performance and integration, the NS9750 reduces the overall cost of developing networked devices, enabling manufacturers to easily include both their application and device networking functionality into a single processor. In 2005, Digi released the NS9360 microprocessor to production supported by new enhanced NET+Works® 6.2 development tools. The NS9360 processor reduces cost and provides superior device networking functionality. With the acquisition of Rabbit Semiconductor, the Company added to its product offering with the addition of the Rabbit family of microprocessors. The Company recently announced the Rabbit 4000 microprocessor, a chip that like its predecessors is designed specifically for embedded control, communications, and Ethernet connectivity but which also adds important new features. Coupled with the Rabbit 4000 is the Dynamic C development and networking software suite.

ITEM 1. BUSINESS (CONTINUED)

APPLICATION MARKETS AND PRODUCTS (CONTINUED)

Embedded Modules – In 2003, Digi extended its line of embedded networking products to include the Digi Connect™ ME and Digi Connect™ EM, small, embedded network modules ideal for network and web-enabling a device. In 2004, the Company expanded its product offering of the Digi Connect ME networking modules to include the Digi Connect Wi-ME™ and Digi Connect Wi-EM™ wireless embedded modules that are pin compatible and interchangeable with the Digi Connect wired embedded modules, allowing customers to easily accommodate both wired and wireless functionality in one product design. While these modules may be used as the main processor of a device, these are most often used as co-processors that manage a device's communications system.

Core Modules and Single-Board Computers – Digi further extended device networking expertise into core modules by introducing its ConnectCore™ line of products, creating the industry's first network-optimized series of 32-bit core modules targeted as the main processor for products including access control systems, point-of-sale systems, RFID readers, medical devices and instrumentation, networked displays, and much more. Digi believes that the acquisitions of FS Forth and Rabbit, together with the ConnectCore product introduction, represent a significant move into the networked core module arena. Core modules provide customers with a networked platform for uses as the main processor in an embedded system and the flexibility to allow them to add features and functionality to get to market very quickly with a network-enabled device. The new features of the aforementioned Rabbit 4000 processor will enhance the Rabbit core module offering and allow Digi to significantly broaden its core module customer base. In addition, the Rabbit acquisition also added a family of single board computers (SBCs). While SBCs offer the same benefits as core modules, they also obviate the need for additional interface circuitry because they include all of the key device interface components on one circuit board.

DISTRIBUTION AND PARTNERSHIPS

The Company's larger U.S. distributors include Ingram Micro, Tech Data Corporation, and Arrow Distributing. Digi also maintains relationships with many other distributors in the U.S., Canada, Europe, Asia Pacific, and Latin America.

Digi maintains strategic alliances with other industry leaders to develop and market technology solutions. These include most major communications software vendors, operating system suppliers, computer hardware manufacturers, and cellular carriers. Key partners include: Microsoft, Citrix Systems, Hewlett Packard, IBM, Motorola, CDW, Dell, Insight, Santa Cruz Operation, Sun Microsystems, Toshiba, Atmel, Green Hills Software, Cingular, Sprint, Verizon, and Alltel. Furthermore, Digi maintains a worldwide network of authorized developers and manufacturing representatives that extends the Company's marketing and selling reach into certain technology applications or geographical regions. Digi has extended its catalog distribution relationships through the Rabbit acquisition, and maintains strong relationships with catalog distributors Digi-Key and Mouser Electronics.

CUSTOMERS

The Company's customer base includes many of the world's largest companies. The Company has strategic sales relationships with leading vendors, allowing them to ship the Company's board and network products as component parts of their overall networking solutions. These vendors include IBM, NCR, Sun Microsystems, Fujitsu Transaction Solutions (Optimal Robotics), Abbott Labs and Hewlett Packard, among others. Many of the world's leading telecommunications companies and internet service providers also rely on the Company's products, including Lucent, AT&T, Cingular, Sprint, Verizon and Siemens. The Company has also established relationships with customers such as Hirschmann, Sauter, Pro Control, Bizerba, AFT Atlas, Ikusi and Metso

ITEM 1. BUSINESS (CONTINUED)

CUSTOMERS (CONTINUED)

Automation, many authorized resellers and OEMs, and catalog distribution customers Digi-Key and Mouser Electronics named above.

One distributor, Tech Data, comprised 12.9%, 15.6% and 15.2% of the Company's net sales for the years ended September 30, 2005, 2004 and 2003, respectively. Another distributor, Ingram Micro, comprised 8.6%, 9.7% and 11.3% of the Company's net sales for the years ended September 30, 2005, 2004 and 2003, respectively.

COMPETITIVE CONDITIONS

The communications technology industry is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. The Company competes for customers on the basis of product performance in relation to compatibility, support, quality and reliability, product development capabilities, price and availability.

The Company believes that it is a global market leader in multi-port serial adapters. As this market continues to mature, the Company is focusing on key applications, customers, and markets to manage applications as they transition to other technologies such as Ethernet, USB, and wireless connectivity products. The Company also believes it is a leader in connecting peripheral devices to LANs with its terminal server and device server product lines and WANs with its cellular product line. The Company believes that the complementary nature of the NetSilicon-branded device connectivity products, along with a line of embeddable core modules acquired as part of the FS Forth and Rabbit acquisitions, will provide an expanded range of products and technology.

Some of the Company's competitors and potential competitors may have greater financial, technological, manufacturing, marketing and personnel resources than the Company. Present and future competitors may be able to identify new markets and develop products which are superior to those developed by the Company and bring such products to market sooner than the Company. They may also adapt new technologies faster, devote greater resources to research and development, promote products more aggressively and price products more competitively than the Company. There are no assurances that competition will not intensify or that the Company will be able to compete effectively in the markets in which the Company competes.

OPERATIONS

The Company's manufacturing operations procure all parts and perform certain services involved in production. Most of the Company's product manufacturing is subcontracted to outside firms that specialize in such services. Digi relies on third party foundries for its semiconductor devices. Currently, Atmel Corporation and Toshiba Corporation manufacture the NET+ARM® semiconductor devices. The Company believes that this approach is beneficial because the Company can reduce its fixed costs, maintain production flexibility and maximize its profits.

The Company's products are manufactured to their designs with standard and semi-custom components. Most of these components are available from multiple vendors. The Company has several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to the Company. If these suppliers are unable to provide a timely and reliable supply of components, the Company could experience manufacturing delays that adversely affect its consolidated results of operations.

During fiscal years 2005, 2004 and 2003, the Company's research and development expenditures were $16.5 million, $17.2 million and $16.0 million, respectively. Due to rapidly changing technology in the communications technology industry, the Company believes that its success depends primarily upon the

ITEM 1. BUSINESS (CONTINUED)

OPERATIONS (CONTINUED)

engineering, marketing, manufacturing and support skills of its personnel. Digi's proprietary rights and technology are protected by a combination of copyrights, trademarks, trade secrets and patents. The Company has established common law and registered trademark rights on a family of marks for a number of its products.

As of September 30, 2005, the Company had backlog orders which management believed to be firm in the amount of $9.0 million. All of these orders are expected to be shipped in fiscal 2006. Backlog as of September 30, 2004 was $7.0 million and $5.8 million as of September 30, 2003. Backlog as of any particular date is not necessarily indicative of the Company's future sales trends.

The Company had 481 employees on September 30, 2005 compared to 341 on September 30, 2004. The increase in the number of employees in fiscal 2005 is primarily due to the addition of 155 employees as a result of the acquisitions of Rabbit and FS Forth, partially offset by normal attrition.

DIGI INTERNATIONAL WEBSITE

The Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available through the Company's website (www.digi.com) under the "About us – Investor Relations" caption or by writing to Digi International, Inc. This information is available free of charge as soon as reasonably practicable after the Company electronically files such material with the Securities and Exchange Commission. These reports can also be accessed via the SEC website, www.sec.gov, or via the SEC's Public Reference Room located at 150 F Street, N.E., Room 1580, Washington, D.C. 20549. Information concerning the operation of the SEC's Public Reference Room can be obtained by calling 1-800-SEC-0330.

The Company is not including the information on its website as part of, or incorporating it by reference into, its Form 10-K.

ITEM 2. PROPERTIES

The following table contains a listing of the Company's current property locations:

Location of Property	Use of Facility	Approximate Square Footage	Ownership or Lease Expiration Date
Minnetonka, MN (Corporate headquarters)	Research and development, sales, sales support, marketing, and administration	130,000	Owned
Eden Prairie, MN	Manufacturing and warehousing	58,000	Owned
Waltham, MA	Research and development, sales, sales support, marketing, and administration	21,759	September 2007
Austin, TX	Sales, sales support, marketing, and administration	6,563	March 2008
Davis, CA	Sales, sales support, manufacturing and warehousing	24,000	December 2012
Davis, CA	Marketing, research & development, and administration	11,200	September 2008
Hong Kong, China	Sales, marketing, and administration	3,413	August 2007
Beijing, China	Sales, marketing, and administration	2,372	December 2006
Dortmund, Germany	Sales, sales support, marketing, and administration	65,348	Owned
Breisach, Germany	Sales, marketing, research & development, manufacturing, warehousing and administration	8,748	December 2008
Logrono, Spain	Sales, research & development, and administration	1,291	September 2007
Tokyo, Japan	Sales	1,371	November 2005

In addition to the above locations, the Company performs research and development activities in various other locations in the United States and sales activities in various other locations in Europe and China which are not deemed to be principal locations. Management believes that the Company's facilities are adequate for its needs. The Company is attempting to sell the Dortmund, Germany facility.

ITEM 3. LEGAL PROCEEDINGS

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of NetSilicon and approximately 300 other public companies. The complaint names as defendants the Company, NetSilicon, certain of its officers and certain underwriters involved in NetSilicon's IPO, among numerous others, and asserts, among other things, that NetSilicon's IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon's IPO underwriters in allocating shares in NetSilicon's IPO to the underwriters' customers. The Company believes that the claims against the NetSilicon defendants are without merit and has defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

ITEM 3. LEGAL PROCEEDINGS (CONTINUED)

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

Consummation of the proposed settlement remains conditioned upon obtaining approval by the Court. On September 1, 2005, the Court preliminarily approved the proposed settlement, directed that notice of the terms of the proposed settlement be provided to class members, and scheduled a fairness hearing, at which objections to the proposed settlement will be heard. Thereafter, the Court will determine whether to grant final approval to the proposed settlement.

If the proposed settlement is not consummated, the Company intends to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of this pending lawsuit. The Company maintains liability insurance for such matters and expects that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of September 30, 2005, the Company has accrued a liability for the deductible amount of $250,000 which the Company believes reflects the amount of loss that is probable. In the event the Company has losses that exceed the limits of the liability insurance, such losses could have a material effect on the business, or consolidated results of operations or financial condition of the Company.

On April 13, 2004, the Company filed a lawsuit against Lantronix Inc. (Lantronix) alleging that certain of Lantronix's products infringe the Company's U.S. Patent No. 6,446,192. The Company filed the lawsuit in the U.S. District Court in Minnesota. The lawsuit seeks both monetary and non-monetary relief. On May 3, 2004, Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,571,305, in the U.S. District Court for the Central District of California. The lawsuit seeks both monetary and non-monetary relief. On February 7, 2005 Lantronix and Acticon Technologies LLC filed a lawsuit against the Company alleging that certain of the Company's products infringe U.S. Patent No. 4,972,470. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit seeks both monetary and non-monetary relief. On May 12, 2005 Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,881,096. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit seeks both monetary and non-monetary relief. The Company believes the impact of these disputes on the business, or consolidated results of operations or financial condition of the Company, will not be material.

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

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

There were no matters submitted to the vote of security holders during the quarter ended September 30, 2005.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Stock Listing

The Company's Common Stock trades on the NASDAQ National Market tier of the NASDAQ Stock Market™ under the symbol "DGII." On November 21, 2005, the number of holders of the Company's Common Stock was approximately 8,387, consisting of 219 record holders and approximately 8,168 stockholders whose stock is held by a bank, broker or other nominee.

The number of securities issuable under equity compensation plans and the related weighted-average exercise price is described in Part III, Item 12, Equity Compensation Plan Information.

High and low sale prices for each quarter during the years ended September 30, 2005 and 2004, as reported on the NASDAQ Stock Market, were as follows:

Stock Prices

2005	First	Second	Third	Fourth
High	$ 17.53	$ 17.25	$ 13.89	$ 14.79
Low	$ 11.59	$ 13.24	$ 10.11	$ 9.75

2004	First	Second	Third	Fourth
High	$ 9.70	$ 12.33	$ 10.85	$ 12.18
Low	$ 6.61	$ 9.26	$ 8.56	$ 9.89

Dividend Policy

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

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

Issuer Repurchases of Equity Securities

The Company did not repurchase any of its equity securities in the quarter ended September 30, 2005.

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ITEM 6. SELECTED FINANCIAL DATA

(in thousands except per common share amounts and number of employees)

For the fiscal years ended September 30	2005	2004	2003	2002	2001
Net sales	$ 125,198	$ 111,226	$ 102,926	$ 101,536	$ 130,405
Gross profit	$ 75,682	$ 67,783	$ 61,346	$ 55,524	$ 64,212
Sales, marketing, general and administrative	41,894	38,843	40,258	48,364	46,968
Research and development	16,531	17,159	15,968	19,530	18,335
Restructuring	—	—	(600)	2,696	1,121
Acquired in-process research and development	300	—	—	3,100	—
Loss on sale of MiLAN assets	—	—	—	3,617	—
Gain from forgiveness of grant payable	—	—	(553)	(1,068)	—
Operating income (loss)	16,957	11,781	6,273	(20,715)	(2,212)
Total other income, net	1,026	369	296	1,255	2,397
Income (loss) before income taxes and cumulative effect of accounting change	17,983	12,150	6,569	(19,460)	185
Income tax provision (benefit)	318	3,487	(23)	(6,675)	66
Income (loss) before cumulative effect of accounting change	17,665	8,663	6,592	(12,785)	119
Cumulative effect of accounting change	—	—	(43,866)	—	(1,902)
Net income (loss)	$ 17,665	$ 8,663	$ (37,274)	$ (12,785)	$ (1,783)
Net income (loss) per common share, basic:					
Income (loss) before cumulative effect of accounting change	$ 0.79	$ 0.41	$ 0.31	$ (0.65)	$ —
Cumulative effect of accounting change	—	—	(2.08)	—	(0.12)
Net income (loss) per common share	$ 0.79	$ 0.41	$ (1.77)	$ (0.65)	$ (0.12)
Net income (loss) per common share, diluted:					
Income (loss) before cumulative effect of accounting change	$ 0.76	$ 0.39	$ 0.31	$ (0.65)	$ —
Cumulative effect of accounting change	—	—	(2.07)	—	(0.12)
Net income (loss) per common share	$ 0.76	$ 0.39	$ (1.76)	$ (0.65)	$ (0.12)
Working capital (total current assets less total current liabilities)	$ 69,995	$ 82,090	$ 57,793	$ 62,662	$ 74,233
Total assets	177,631	150,465	132,540	180,828	139,453
Long-term debt and capital lease obligations	1,181	—	—	4,989	5,499
Stockholders’ equity	153,537	127,079	105,863	151,180	112,917
Book value per common share	6.78	5.83	5.23	6.80	7.39
Number of employees	481	341	358	407	425

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

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

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

The future operating results and performance trends of the Company may be affected by a number of factors, including, without limitation, those described under "Risk Factors" below. Those risk factors, and other risks, uncertainties and assumptions identified from time to time in the Company's filings with the Securities and Exchange Commission, including without limitation, its quarterly reports on Form 10-Q and its registration statements, could cause the Company's actual future results to differ materially from those projected in the forward-looking statements as a result of the factors set forth in the Company's various filings with the Securities and Exchange Commission and of changes in general economic conditions, changes in interest rates and/or exchange rates and changes in the assumptions used in making such forward-looking statements.

RISK FACTORS

The Company's dependence on new product development and the rapid technological change that characterizes the Company's industry make it susceptible to loss of market share resulting from competitors' product introductions and similar risks.

The communications technology industry is characterized by rapidly changing technologies, evolving industry standards, frequent new product introductions, short product life cycles and rapidly changing customer requirements. The introduction of products embodying new technologies and the emergence of new industry standards can render existing products obsolete and unmarketable. The Company's future success will depend on its ability to enhance its existing products, to introduce new products to meet changing customer requirements and emerging technologies, and to demonstrate the performance advantages and cost-effectiveness of its products over competing products. Failure by the Company to modify its products to support new alternative technologies or failure to achieve widespread customer acceptance of such modified products could cause the Company to lose market share and cause its revenues to decline.

The Company may experience delays in developing and marketing product enhancements or new products that respond to technological change, evolving industry standards and changing customer requirements. There can be no assurance that the Company will not experience difficulties that could delay or prevent the successful development, introduction, and marketing of these products or product enhancements, or that its new products and product enhancements will adequately meet the requirements of the marketplace and achieve any significant or sustainable degree of market acceptance in existing or additional markets. Failure by the

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RISK FACTORS (CONTINUED)

Company, for technological or other reasons, to develop and introduce new products and product enhancements in a timely and cost-effective manner could have a material adverse effect on the Company. In addition, the future introductions or announcements of products by the Company or one of its competitors embodying new technologies or changes in industry standards or customer requirements could render the Company's then-existing products obsolete or unmarketable. There can be no assurance that the introduction or announcement of new product offerings by the Company or one or more of its competitors will not cause customers to defer the purchase of the Company's existing products, which could cause its revenues to decline.

The Company intends to continue to devote significant resources to its research and development, which, if not successful, could cause a decline in its revenues and harm its business.

The Company intends to continue to devote significant resources to research and development in the coming years to enhance and develop additional products. For the fiscal years ended 2005, 2004, and 2003, the Company's research and development expenses comprised 13.2%, 15.4%, and 15.5%, respectively, of total net sales. If the Company is unable to develop new products as a result of its research and development efforts, or if the products the Company develops are not successful, its business could be harmed. Even if the Company develops new products that are accepted by its target markets, the net revenues from these products may not be sufficient to justify its investment in research and development.

A substantial portion of the Company's recent development efforts have been directed toward the development of new products targeted to manufacturers of intelligent, network-enabled devices and other embedded systems in various markets, including markets in which networking solutions for embedded systems have not historically been sold, such as markets for industrial automation equipment, security equipment and medical equipment. The Company's financial performance is dependent upon the development of the intelligent device markets that the Company is targeting, and the Company's ability to successfully compete and sell its products to manufacturers of these intelligent devices.

Certain of the Company's products that generate a substantial amount of its revenue are sold into mature markets, which could limit the Company's ability to continue to generate revenue from these products.

Certain of the Company's products provide asynchronous and synchronous data transmissions via add-on cards. The market for add-on asynchronous and synchronous data communications cards is mature. Furthermore, certain applications of the Company's embedded network interface cards are also considered mature. Asynchronous, synchronous, and network interface cards generated approximately 37.5% of the Company's revenues in fiscal 2005. As the overall market for these products decreases due to the adoption of new technologies, the Company expects that its revenues from these products will continue to decline. As a result, the Company's future prospects depend in large part on its ability to acquire or develop and successfully market additional products that address growth markets.

The Company's failure to effectively manage product transitions could have a material adverse effect on the Company's revenues and profitability.

From time to time, the Company or its competitors may announce new products, capabilities, or technologies that may replace or shorten the life cycles of the Company's existing products. Announcements of currently planned or other new products may cause customers to defer or stop purchasing the Company's products until new products become available. Furthermore, the introduction of new or enhanced products requires the Company to manage the transition from older product inventories and ensure that adequate supplies of new

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RISK FACTORS (CONTINUED)

products can be delivered to meet customer demand. The Company's failure to effectively manage transitions from older products could have a material adverse effect on the Company's revenues and profitability.

The Company's failure to compete successfully in its highly competitive market could result in reduced prices and loss of market share.

The market in which the Company operates is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. The Company competes for customers on the basis of product performance in relation to compatibility, support, quality and reliability, product development capabilities, price, and availability. Certain of the Company's competitors and potential competitors may have greater financial, technological, manufacturing, marketing, and personnel resources than the Company. Present and future competitors may be able to identify new markets and develop products more quickly, which are superior to those developed by the Company. They may also adapt new technologies faster, devote greater resources to research and development, promote products more aggressively, and price products more competitively than the Company. There are no assurances that competition will not intensify or that the Company will be able to compete effectively in the markets in which the Company competes.

The cyclicality of the semiconductor industry may result in substantial period-to-period fluctuations in operating results.

The Company's semiconductor products provide networking capabilities for intelligent, network-enabled devices and other embedded systems. The semiconductor industry is highly cyclical and subject to rapid technological change and has been subject to significant economic downturns at various times, characterized by diminished product demand, accelerated erosion of average selling prices and production overcapacity. The semiconductor industry also periodically experiences increased demand and production capacity constraints. As a result, the Company may experience substantial period-to-period fluctuations in operating results due to general semiconductor industry conditions.

Loss of one or more of the Company's key customers could have an adverse effect on the Company's revenues.

Tech Data and Ingram Micro, distributors, comprised 12.9% and 8.6% of net sales, respectively, during the fiscal year ended 2005. During fiscal 2004 and 2003 Tech Data comprised 15.6% and 15.2% of net sales, respectively, and Ingram Micro comprised 9.7% and 11.3% of net sales, respectively. The potential loss of distributors Tech Data and Ingram Micro would have less impact than if end-user customers were lost. The Company's sales are primarily made on the basis of purchase orders rather than under long-term agreements, and therefore, any customer could cease purchasing the Company's products at any time without penalty. The decision of any key customer to cease using the Company's products or a material decline in the number of units purchased by a significant customer could have a material adverse effect on the Company's revenues.

The long and variable sales cycle for certain of the Company's products makes it more difficult for the Company to predict its operating results and manage its business.

The sale of the Company's products typically involves a significant technical evaluation and commitment of capital and other resources by potential customers and end users, as well as delays frequently associated with end users' internal procedures to deploy new technologies within their products and to test and accept new

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RISK FACTORS (CONTINUED)

technologies. For these and other reasons, the sales cycle associated with certain of the Company's products is typically lengthy and is subject to a number of significant risks, including end users' internal purchasing reviews, that are beyond the Company's control. Because of the lengthy sales cycle and the large size of certain customer orders, if orders forecasted for a specific customer for a particular quarter are not realized in that quarter, the Company's operating results for that quarter could be materially adversely affected.

The Company depends on manufacturing relationships and on limited-source suppliers, and any disruptions in these relationships may cause damage to the Company's customer relationships.

The Company procures all parts and certain services involved in the production of its products and subcontracts most of its product manufacturing to outside firms that specialize in such services. Although most of the components of the Company's products are available from multiple vendors, the Company has several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous to the Company. There can be no assurance that the Company's suppliers will be able to meet the Company's future requirements for products and components in a timely fashion. In addition, the availability of many of these components to the Company is dependent in part on the Company's ability to provide its suppliers with accurate forecasts of its future requirements. Delays or lost sales could be caused by other factors beyond the Company's control, including late deliveries by vendors of components. If the Company is required to identify alternative suppliers for any of its required components, qualification and pre-production periods could be lengthy and may cause an increase in component costs and delays in providing products to customers. Any extended interruption in the supply of any of the key components currently obtained from limited sources could disrupt the Company's operations and have a material adverse effect on the Company's customer relationships and profitability.

The Company's use of suppliers in Southeast Asia involves risks that could negatively impact the Company.

The Company uses suppliers in Southeast Asia. Product delivery times may be extended due to the distances involved, requiring more lead-time in ordering. In addition, ocean freight delays may occur as a result of labor problems, weather delays or expediting and customs issues. Any extended delay in receipt of the component parts could eliminate anticipated cost savings and have a material adverse effect on the Company's customer relationships and profitability.

The Company's ability to compete could be jeopardized if the Company is unable to protect its intellectual property rights.

The Company's ability to compete depends in part on its proprietary rights and technology. Its proprietary rights and technology are protected by a combination of copyrights, trademarks, trade secrets and patents.

The Company enters into confidentiality agreements with all employees, and sometimes with its customers and potential customers, and limits access to the distribution of its proprietary information. There can be no assurance that the steps taken by the Company in this regard will be adequate to prevent the misappropriation of its technology. The Company's pending patent applications may be denied and any patents, once issued, may be circumvented by the Company's competitors. Furthermore, there can be no assurance that others will not develop technologies that are superior to the Company's technologies. Despite the Company's efforts to protect

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RISK FACTORS (CONTINUED)

its proprietary rights, unauthorized parties may attempt to copy aspects of its products or to obtain and use information that the Company regards as proprietary. In addition, the laws of some foreign countries do not protect the Company's proprietary rights as fully as do the laws of the United States. There can be no assurance that the Company's means of protecting its proprietary rights in the United States or abroad will be adequate or that competing companies will not independently develop similar technology. The Company's failure to adequately protect its proprietary rights could have a material adverse effect on the Company's competitive position and result in loss of revenue.

From time to time, the Company is subject to claims and litigation regarding intellectual property rights or other claims, which could seriously harm the Company and require the Company to incur significant costs.

The communications technology industry is characterized by frequent litigation regarding patent and other intellectual property rights. From time to time, the Company receives notification of a third-party claim that its products infringe other intellectual property rights. Any litigation to determine the validity of third-party infringement claims, whether or not determined in the Company's favor or settled by the Company, may be costly and divert the efforts and attention of the Company's management and technical personnel from productive tasks, which could have a material adverse effect on the Company's ability to operate its business and service the needs of its customers. There can be no assurance that any infringement claims by third parties, if proven to have merit, will not materially adversely affect the Company's business or financial condition. In the event of an adverse ruling in any such matter, the Company may be required to pay substantial damages, cease the manufacture, use and sale of infringing products, discontinue the use of certain processes or be required to obtain a license under the intellectual property rights of the third party claiming infringement. There can be no assurance that a license would be available on reasonable terms or at all. Any limitations on the Company's ability to market its products, or delays and costs associated with redesigning its products or payments of license fees to third parties, or any failure by the Company to develop or license a substitute technology on commercially reasonable terms could have a material adverse effect on its business and financial condition. (See Item 3 and Note 15 to the Company's Consolidated Financial Statements.)

The Company faces risks associated with its international operations and expansion that could impair its ability to grow its revenues abroad.

In the fiscal years ended September 30, 2005, 2004, and 2003, net sales to customers outside the United States were approximately 42.5%, 44.2%, and 35.5%, respectively, of total net sales.

The Company believes that its future growth is dependent in part upon its ability to increase sales in international markets. These sales are subject to a variety of risks, including fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers, unexpected changes in regulatory requirements, longer accounts receivable payment cycles and potentially adverse tax consequences, and export license requirements. In addition, the Company is subject to the risks inherent in conducting business internationally, including political and economic instability and unexpected changes in diplomatic and trade relationships. There can be no assurance that one or more of these factors will not have a material adverse effect on the Company's business strategy and financial condition.

If the Company loses key personnel it could prevent the Company from executing its business strategy.

The Company's business and prospects depend to a significant degree upon the continuing contributions of its executive officers and its key technical personnel. Competition for such personnel is intense, and there can be

RISK FACTORS (CONTINUED)

no assurance that the Company will be successful in attracting and retaining qualified personnel. Failure to attract and retain key personnel could result in the Company's failure to execute its business strategy.

Unanticipated changes in the Company's tax rates could affect its future results.

The Company's future effective tax rates could be favorably or unfavorably affected by unanticipated changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of the Company's deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, the Company may be subject to the examination of its income tax returns by the Internal Revenue Service and other U.S. and international tax authorities. The Company regularly assesses the potential outcomes resulting from these examinations to determine the adequacy of its provision for income taxes. There can be no assurance that the outcomes from these examinations will not have an effect on the Company's consolidated operating results and financial condition.

Any acquisitions the Company has made or will make could disrupt its business and seriously harm its financial condition.

The Company will continue to consider acquisitions of complementary businesses, products or technologies. In the event of any future purchases, the Company could issue stock that would dilute the Company's current stockholders' percentage ownership; incur debt; assume liabilities; or incur large and immediate write-offs.

The Company's operation of any acquired business may also involve numerous risks, including:

- problems combining the purchased operations, technologies, or products;
- unanticipated costs;
- diversion of management's attention from the Company's core business;
- difficulties integrating businesses in different countries and cultures;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which the Company has no or limited prior experience; and
- potential loss of key employees, particularly those of the purchased organization.

The Company cannot assure that it will be able to successfully integrate any businesses, products, technologies, or personnel that the Company has acquired or that the Company might acquire in the future and any failure to do so could disrupt its business and have a material adverse effect on its financial condition and results of operations. Moreover, from time to time the Company may enter into negotiations for a proposed acquisition, but be unable or unwilling to consummate the acquisition under consideration. This could cause significant diversion of management's attention and out-of-pocket expenses to the Company. The Company could also be exposed to litigation as a result of an unconsummated acquisition, including claims that it failed to negotiate in good faith or misappropriated confidential information.

The Company's failure to effectively comply with the requirements of applicable environmental legislation and regulation could have a material adverse effect on the Company's revenues and profitability.

Production and marketing of products in certain states and countries may subject the Company to environmental and other regulations. In addition, certain states and countries may pass regulations requiring the Company's products to meet certain requirements to use environmentally friendly components. Such laws and regulations have recently been passed in jurisdictions in which the Company operates. The European Union has issued two

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

RISK FACTORS (CONTINUED)

directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive (WEEE) makes producers of certain electrical and electronic equipment financially responsible for collection, reuse, recycling, treatment and disposal of equipment placed in the European Union market after August 13, 2005. The Restrictions of Hazardous Substances Directive (RoHS) bans the use of certain hazardous materials in electric and electrical equipment which are put on the market in the European Union after July 1, 2006. In the future, China and other countries are expected to adopt environmental compliance programs. If the Company fails to comply with these regulations, it may not be able to sell its products in jurisdictions where these regulations apply which could have a material adverse effect on the Company's revenues and profitability.

NON-GAAP FINANCIAL MEASURES

Management believes that there are certain non-GAAP financial measures that provide useful information to investors regarding the Company's results of operations and financial condition which permit a more meaningful comparison and understanding of the Company's operating performance. These non-GAAP financial measures are discussed in the 2005 Letter to Stockholders and the "Income Taxes" section of Management's Discussion and Analysis of Financial Condition and Results of Operation. These non-GAAP financial measures are as follows:

- earnings before income taxes, depreciation and amortization (EBTDA);
- income before income taxes and cumulative effect of accounting change excluding unusual items;
- earnings per diluted share, excluding the impact of the favorable tax settlement

With respect to the measures that exclude the favorable tax settlement, management believes that excluding this item provides useful information to investors regarding the Company's consolidated results of operations and financial condition and permits a more meaningful comparison and understanding of the Company's operating performance. Management believes that EBTDA helps investors compare operating results and corporate performance exclusive of the impact of the Company's capital structure and the method by which assets were acquired. In addition, the incentive compensation plans for the Company's employees, including executive officers, are partially based on achievement of defined earnings before taxes, depreciation and amortization targets, and the Company monitors this statistic on a quarterly basis.

Management uses these various non-GAAP measures to monitor and evaluate ongoing operating results and trends and to gain an understanding of the comparative operating performance of the Company.

The Company does not consider the non-GAAP financial measures listed above to be substitutes for performance measured in accordance with GAAP. Investors should also view the GAAP measures as the most complete measure of the Company's overall financial performance.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NON-GAAP FINANCIAL MEASURES (CONTINUED)

The following tables disclose a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures, which are net income (loss), income before income taxes and cumulative effect of accounting change and net income per common share, diluted.

Reconciliation of Net Income (Loss) to Earnings before Taxes, Depreciation, and Amortization
($ in thousands)

	Year Ended September 30,							
	2005		2004		2003		2002	
	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales
Net sales	$125,198	100.0%	$111,226	100.0%	$102,926	100.0%	$101,536	100.0%
Net income (loss)	$ 17,665		$ 8,663		$ (37,274)		$ (12,785)	
Income tax provision (benefit)	318		3,487		(23)		(6,675)	
Income (loss) before income taxes	17,983		12,150		(37,297)		(19,460)	
Depreciation and amortization	8,870		8,597		10,303		11,568	
EBTDA	$ 26,853	21.4%	$ 20,747	18.7%	$ (26,994)	-26.2%	$ (7,892)	-7.8%

Reconciliation of Income before Income Taxes and Cumulative Effect of Accounting Change
to Effective Tax Rate on Income Before Income Taxes and
Cumulative Effect of Accounting Change, Excluding Unusual Items
($ in thousands)

	Year ended September 30,		
	2005	2004	2003
Income before income taxes and cumulative effect of accounting change	$ 17,983	$ 12,150	$ 6,569
Income tax provision (benefit) as reported	$ 318	$ 3,487	$ (23)
Unusual items:			
Impact of favorable tax settlement	(5,689)	—	—
Impact of reversal of valuation allowance	—	—	(1,415)
Income tax provision, excluding unusual items	$ 6,007	$ 3,487	$ 1,392
Effective tax rate on income before income taxes and cumulative effect of accounting change as reported	1.8%	28.7%	-0.3%
Effective tax rate on income before income taxes and cumulative effect of accounting change, excluding unusual items	33.4%	28.7%	21.2%

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NON-GAAP FINANCIAL MEASURES (CONTINUED)

Reconciliation of Net Income Per Common Share, Diluted to
Net Income Per Common Share, Diluted Excluding Favorable Tax Settlement
(in thousands, except per share amounts)

	Year ended September 30, 2005	2004
Net income as reported	$ 17,665	$ 8,663
Impact of favorable tax settlement	(5,689)	—
Net income excluding impact of favorable tax settlement	$ 11,976	$ 8,663
Net income per common share, diluted, as reported	$ 0.76	$ 0.39
Impact of favorable tax settlement	$ (0.24)	$ —
Net income per common share, diluted, excluding impact of favorable tax settlement	$ 0.51	$ 0.39
Weighted average common shares, diluted	23,371	22,031

OVERVIEW

Digi operates in the communications technology industry, which is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. Digi provides device connectivity solutions, and all products connect devices to networks in various commercial environments. Digi believes that its products and technologies are cost-effective and easy to use, and Digi places a high priority on development of innovative products that provide differentiated features and functions and allow for ease of integration with customers' applications. Core technology is being migrated across product lines to provide additional functionality for customers and allow them to get to market with networked-enabled devices faster.

During fiscal 2005, Digi developed and released many innovative new products while improving execution of the Company's sales and marketing activities. Digi also placed a high priority on improving the Company's total operating expense to net sales ratio which was 46.9% in fiscal 2005 compared to 50.3% and 54.0% in fiscal 2004 and fiscal 2003, respectively. Innovative new product introductions, together with a focus on simplifying infrastructure to improve operational efficiencies and a cost containment focus throughout the Company, created a strong increase in operating income to 13.5% of net sales in fiscal 2005 compared to 10.6% and 6.1% in fiscal 2004 and fiscal 2003, respectively.

The Company operates in two reportable segments, the Connectivity Solutions segment and the Device Networking Solutions segment (see Note 6 to the Company's Consolidated Financial Statements.) The Connectivity Solutions segment includes products that are mature and are in flat to declining markets as well as products that have recently been introduced and are in growing markets. Declining sales of products in the mature product lines within this segment were offset by increasing sales of growth products in this segment, resulting in a $2.0 million increase in sales levels in fiscal 2005 compared to fiscal 2004 and a $1.4 million increase in sales levels in fiscal 2004 compared to fiscal 2003. Although total sales in the Connectivity Solutions segment increased in fiscal 2005 compared to fiscal 2004, operating income in

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

OVERVIEW (CONTINUED)

this segment declined in fiscal 2005 relative to the prior year as the continuing decline in net sales of the multi-port serial adapter products resulted in a reduction in margins. Improved margins and lower operating expenses resulted in an increase in Connectivity Solutions segment operating income during fiscal 2004 compared to fiscal 2003. The Company's strategy is to focus on key applications, customers and markets to efficiently manage the migration from mature products and applications to other newer technologies.

The Company expects continued long-term growth in the Device Networking Solutions segment. Net sales in the Device Networking Solutions segment increased during the three year period ended September 30, 2005. Increased net sales as a result of the Rabbit and FS Forth acquisitions resulted in a decrease in operating loss during fiscal 2005 compared to fiscal 2004. Higher revenue and lower operating costs offset a decline in gross profit margins resulting in a decrease in operating loss during fiscal 2004 compared to fiscal 2003. The Company believes the complementary nature of the device networking products, along with a line of embeddable modules, enhanced by product additions resulting from the Rabbit and FS Forth acquisitions, will provide an expanded range of products and technology in the future and will allow customers to migrate from an external box to a board or module and eventually to a fully integrated chip without making major changes to their software platforms.

As Digi continues to work toward its objective of seamless migration for its customers through connectivity technologies, with a goal of maintaining its leadership position in commercial grade device networking, the segments described above are being reevaluated. This evaluation results from the migration of core technology across product lines, as well as changes in the Company's infrastructure that affects the way management views and assesses its business. The Company is considering a change to a single reporting segment in the first quarter of fiscal 2006 as a result of this reevaluation.

The Company intends to continue to extend its current product lines with next generation commercial grade device networking products and technologies targeted for selected commercial markets, such as point of sale, industrial automation, office automation, building controls and medical. The Company believes that there is a market trend of device connectivity in these commercial applications that will require communications intelligence or connectivity to the network or the internet. These devices will be used for basic data communications, management, monitoring and control, and maintenance. The Company believes that it is well positioned to leverage its current products and technologies to take advantage of this market trend.

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information from the Company's Consolidated Statements of Operations, expressed as a percentage of net sales and as a percentage of change from year-to-year for the years indicated.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

CONSOLIDATED RESULTS OF OPERATIONS (CONTINUED)

($'s in thousands)	Year ended September 30, 2005		2004		2003		% Increase (decrease) 2005 Compared to 2004	2004 Compared to 2003
Net sales	$ 125,198	100.0%	$ 111,226	100.0%	$ 102,926	100.0%	12.6%	8.1%
Cost of sales	49,516	39.6	43,443	39.1	41,580	40.4	14.0	4.5
Gross profit	75,682	60.4	67,783	60.9	61,346	59.6	11.7	10.5
Operating expenses:								
Sales and marketing	26,339	21.1	25,556	23.0	24,734	24.0	3.1	3.3
Research and development	16,531	13.2	17,159	15.4	15,968	15.5	(3.7)	7.5
General and administrative	10,005	8.0	8,064	7.2	9,039	8.8	24.1	(10.8)
Identifiable intangibles amortization	5,550	4.4	5,223	4.7	6,485	6.3	6.3	(19.5)
Restructuring	—	—	—	—	(600)	(0.6)	N/M	N/M
In-process research and development	300	0.2	—	—	—	—	N/M	—
Total operating expenses	58,725	46.9	56,002	50.3	55,626	54.0	4.9	0.7
Gain from forgiveness of grant payable	—	—	—	—	553	0.5	N/M	N/M
Operating income	16,957	13.5	11,781	10.6	6,273	6.1	43.9	87.8
Total other income, net	1,026	0.9	369	0.3	296	0.3	178.0	24.9
Income before income taxes and cumulative effect of accounting change	17,983	14.4	12,150	10.9	6,569	6.4	48.0	85.0
Income tax provision (benefit)	318	0.3	3,487	3.1	(23)	(0.0)	(90.9)	N/M
Income before cumulative effect of accounting change	17,665	14.1	8,663	7.8	6,592	6.4	103.9	31.4
Cumulative effect of accounting change	—	—	—	—	(43,866)	(42.6)	N/M	N/M
Net income (loss)	$ 17,665	14.1%	$ 8,663	7.8%	$ (37,274)	(36.2)%	103.9%	123.2%

N/M means not meaningful

NET SALES

Net sales were $125.2 million in fiscal 2005 compared to $111.2 million in fiscal 2004. Digi improved its competitive position in fiscal 2005 with two acquisitions and innovative product introductions in both of its business segments creating an increase in net sales of $14.0 million or 12.6% compared to fiscal 2004. The Company competes for customers on the basis of product performance in relation to compatibility, support, quality and reliability, product development capabilities, price and availability. As a result of continued market penetration of the device server product lines, revenue increases in the Company's other growth product lines, including product lines inherited through recent acquisitions, and the introduction of the cellular products, the Company offset the volume declines from its mature markets, primarily multi-port serial adaptors and network interface cards (NICs). Due to customer and product mix changes, the Company has experienced an increase in the average selling price of its products. Fluctuation in foreign currency rates compared to the prior year's rates had a favorable impact on net sales of $0.7 million and $1.7 million in fiscal 2005 and 2004, respectively. The $14.0 million, or 12.6% increase in net sales from 2004 to 2005, and the $8.3 million, or 8.1% increase in net sales from 2003 to 2004, occurred within the Company's reportable business segments as displayed below.

The following table sets forth revenue by segment:

($ in millions)	Net Sales 2005	2004	2003	% of Net Sales 2005	2004	2003
Connectivity Solutions	$ 75.5	$ 73.5	$ 72.1	60.3%	66.1%	70.1%
Device Networking Solutions	49.7	37.7	30.8	39.7%	33.9%	29.9%
Total	**$ 125.2**	**$ 111.2**	**$ 102.9**	**100.0%**	**100.0%**	**100.0%**

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NET SALES (CONTINUED)

Digi continues to enhance and introduce products into the market. Connectivity Solutions net sales increased $2.0 million in fiscal 2005 compared to fiscal 2004 due to an increase in growth products within this segment. Growth products within this segment are comprised of USB, terminal servers, and cellular products. Mature products within this segment include Integrated Services Digital Network (ISDN), Remote Access Server (RAS), synchronous, and asynchronous products. Net sales of mature products declined $6.2 million in 2005 compared to 2004, primarily due to market maturity of the multi-port serial adaptor products. Device Networking Solutions sales increased $12.0 million in fiscal 2005 compared to fiscal 2004. Rabbit contributed $10.6 million of revenue from the date of acquisition, May 26, 2005, through the end of fiscal 2005. The balance of the increase in Device Networking Solutions net sales is primarily due to continued market penetration, introduction of new products, new customers reaching production volumes, and other acquisitions with complementary product lines. In fiscal 2005 the Device Networking Solutions segment experienced an accelerated decline in mature NIC net sales as a result of OEMs migrating from NICs to software only solutions.

The communications technology industry stabilized in fiscal 2004 contributing to the Company's increased net sales. Digi continued to enhance its channel strategy including employing additional channel partners and releasing product line enhancements. Connectivity Solutions net sales were $1.4 million higher in fiscal 2004 compared to fiscal 2003 due to an increase in growth products within this segment. Net sales of mature products in this segment remained relatively flat between fiscal 2004 and fiscal 2003. Device Networking Solutions net sales increased $6.9 million in fiscal 2004 compared to fiscal 2003. The increase is mainly due to improved channel execution, continued market penetration of the device server product line, the introduction of new products and new customers reaching production.

The Company's revenue is generated from these distribution channels: OEMs, distributors, and direct. The following tables present the Company's revenue by channel and by geographic location of the customers, as displayed by reporting segment:

($ in millions)	Net Sales			% of Net Sales		
	2005	2004	2003	2005	2004	2003
OEM Channel						
Connectivity Solutions	$ 11.0	$ 13.7	$ 14.2	8.8%	12.3%	13.8%
Device Networking Solutions	34.3	29.3	25.2	27.4%	26.3%	24.5%
Total OEM Channel	**$ 45.3**	**$ 43.0**	**$ 39.4**	**36.2%**	**38.6%**	**38.3%**
Distribution Channel						
Connectivity Solutions	$ 50.3	$ 50.0	$ 47.8	40.2%	45.0%	46.5%
Device Networking Solutions	12.2	6.4	4.4	9.7%	5.8%	4.2%
Total Distribution Channel	**$ 62.5**	**$ 56.4**	**$ 52.2**	**49.9%**	**50.8%**	**50.7%**
Direct Channel						
Connectivity Solutions	$ 14.2	$ 9.8	$ 10.1	11.3%	8.8%	9.8%
Device Networking Solutions	3.2	2.0	1.2	2.6%	1.8%	1.2%
Total Direct Channel	**$ 17.4**	**$ 11.8**	**$ 11.3**	**13.9%**	**10.6%**	**11.0%**
Company						
Connectivity Solutions	$ 75.5	$ 73.5	$ 72.1	60.3%	66.1%	70.1%
Device Networking Solutions	49.7	37.7	30.8	39.7%	33.9%	29.9%
Total Company	**$ 125.2**	**$ 111.2**	**$ 102.9**	**100.0%**	**100.0%**	**100.0%**

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

NET SALES (CONTINUED)

The increase in OEM channel net sales during the last three fiscal years was primarily due to the Company's entrance into the device networking market through the acquisitions of NetSilicon and Rabbit. The majority of NetSilicon and Rabbit customers are OEMs. The decline in Connectivity Solutions net sales within the OEM channel during the last three fiscal years was related to a continued decline in demand in the communications technology industry associated with the decline in certain mature markets. The increase in Device Networking Solutions net sales within the OEM channel was due to the expansion of product offerings and the ramp up of new customers reaching production volumes.

The increase in the distribution channel net sales over the last three fiscal years was primarily due to the Company maintaining its channel strategy, which includes employing additional channel partners and releasing product line enhancements. This strategy resulted in maintaining the Connectivity Solutions distribution channel net sales while increasing the Device Networking Solutions distribution channel net sales.

The increase in the direct channel net sales in fiscal 2005 compared to fiscal 2004 was primarily due to specific Connectivity Solutions deals that the Company determined should go through the direct channel rather than the distribution or OEM channels.

($ in millions)	Net Sales			% of Net Sales		
	2005	2004	2003	2005	2004	2003
International						
Connectivity Solutions	$ 25.0	$ 23.6	$ 24.0	20.0%	21.2%	23.4%
Device Networking Solutions	28.2	25.6	12.5	22.5%	23.0%	12.1%
Total International	**$ 53.2**	**$ 49.2**	**$ 36.5**	**42.5%**	**44.2%**	**35.5%**
Domestic						
Connectivity Solutions	$ 50.5	$ 49.9	$ 48.1	40.3%	44.9%	46.7%
Device Networking Solutions	21.5	12.1	18.3	17.2%	10.9%	17.8%
Total Domestic	**$ 72.0**	**$ 62.0**	**$ 66.4**	**57.5%**	**55.8%**	**64.5%**
Company						
Connectivity Solutions	$ 75.5	$ 73.5	$ 72.1	60.3%	66.1%	70.1%
Device Networking Solutions	49.7	37.7	30.8	39.7%	33.9%	29.9%
Total Company	**$ 125.2**	**$ 111.2**	**$ 102.9**	**100.0%**	**100.0%**	**100.0%**

The increase in international net sales during the last three fiscal years was primarily due to the Company's focus on expansion in the Asia Pacific market as well as incremental international sales resulting from the acquisitions of Rabbit and FS Forth.

The increase in domestic device networking net sales was primarily due to continued market penetration, introduction of new products, new customers reaching production volumes, and acquisitions with complementary product lines.

GROSS PROFIT

Gross profit margin in 2005 was 60.4% compared to 60.9% in 2004. The decrease in gross profit margin was primarily due to sales of Rabbit products with lower gross profit margins. Software licenses, royalties, fees associated with technical support, training, professional and engineering services contributed $1.7 million to gross profit or 1.3% as a percent of net sales in 2005 compared to a contribution of $2.9 million to gross profit or 2.6% as a percent of net sales in 2004.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

GROSS PROFIT (CONTINUED)

Gross profit margin for 2004 was 60.9% compared to 59.6% in 2003. The increase in gross profit margin was primarily due to higher margins in both new and legacy products in the Connectivity Solutions segment and by raw material cost savings across all product lines, in addition to manufacturing and inventory efficiencies.

OPERATING EXPENSES

2005 Compared to 2004

Operating expenses were $58.7 million in 2005, an increase of $2.7 million or 4.9%, compared to operating expenses of $56.0 million in 2004. Incremental operating expenses of $5.4 million were incurred as a result of the acquisitions of Rabbit and FS Forth of which $0.3 million related to in-process research and development associated with the Rabbit 4000 microprocessor. These increases were offset in part by the Company's continued focus on general cost containment in an effort to lower operating expenses as a percent of net sales. Although operating expenses increased $5.4 million as a result of the acquisitions of Rabbit and FS Forth, operating expenses as a percent of net sales improved to 46.9% in fiscal 2005 from 50.3% in fiscal 2004.

Sales and marketing expenses were $26.3 million in 2005, an increase of $0.8 million or 3.1%, compared to sales and marketing expenses of $25.5 million in 2004. The acquisitions of Rabbit and FS Forth, during the third quarter of fiscal 2005, resulted in incremental sales and marketing expense of $1.6 million. This increase was partially offset by a decline in variable sales and marketing expense related to a decline in net sales in certain other product categories, primarily in the network interface card product line.

Research and development expenses were $16.5 million in 2005, a decrease of $0.6 million or 3.7%, compared to research and development expenses of $17.1 million in 2004. The acquisitions of Rabbit and FS Forth resulted in incremental research and development expense of $1.9 million. This increase was offset by a decline in chip fabrication and testing expense due to the timing of chip development. During fiscal 2004, fabrication and testing expenses were incurred for chip projects that were in development. During fiscal 2005, the development phase of these chips ended and the chips have been released into volume production.

General and administrative expenses were $10.0 million in 2005, an increase of $1.9 million or 24.1%, compared to general and administrative expenses of $8.1 million in 2004. Incremental general and administrative expenses were $0.6 million as a result of the acquisitions of Rabbit and FS Forth. In addition, general and administrative expense increased due to increased professional service expense including legal and Section 404 Sarbanes-Oxley related expenses.

Identifiable intangible amortization expenses were $5.5 million in 2005, an increase of $0.3 million or 6.3%, compared to identifiable intangible amortization expenses of $5.2 million in 2004. The acquisitions of Rabbit and FS Forth resulted in increased identifiable intangible amortization expense of $1.0 million. This increase was partially offset by a decline in amortization expense of $0.7 million due to certain purchased technology becoming fully amortized during fiscal 2005.

2004 Compared to 2003

Operating expenses were $56.0 million in 2004, an increase of $0.4 million or 0.7%, compared to operating expenses of $55.6 million in 2003. Operating expenses for 2003 were reduced due to a $0.6 million change in estimate related to the restructuring charge recorded during 2002 primarily due to the renegotiation and settlement of certain previously established severance obligations including related legal fees.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

OPERATING EXPENSES (CONTINUED)

Sales and marketing expenses were $25.6 million in 2004, an increase of $0.9 million, compared to sales and marketing expenses of $24.7 million in 2003. The increase was primarily due to increased commission expense resulting from increased sales. The strengthening of the Euro against the U.S. dollar also unfavorably impacted sales and marketing expense by $0.4 million in fiscal 2004 compared to fiscal 2003.

Research and development expenses were $17.2 million in 2004, an increase of $1.2 million, compared to research and development expenses of $16.0 million in 2003. The Company continued to focus its research and development activities in fiscal 2004 on the development of its device server and chip and software product lines as well as the USB and terminal server product lines. Research and development expense increased between fiscal 2004 and fiscal 2003 primarily due to increased compensation costs related to an increase in personnel required to support the development of remote device management technology.

General and administrative expenses decreased $1.0 million from $9.0 million in 2003 to $8.0 million in 2004. The reduction was primarily due to a decline in legal expense.

Identifiable intangible amortization expense declined $1.3 million as a result of certain purchased technology becoming fully amortized during the third quarter of fiscal 2003.

RESTRUCTURING

In fiscal 2003, the Company recorded a $0.6 million decrease in operating expenses due to a change in estimated severance payments accrued in connection with fiscal 2002 restructuring activities. The change in estimate resulted primarily from favorable settlements in 2003 of previously agreed upon severance amounts including related legal fees.

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT

On May 26, 2005, the Company acquired Rabbit, formerly Z-World, Inc., a privately held corporation for a purchase price of $49.3 million in cash (excluding cash acquired of $0.4 million and assumption of $1.3 million in debt). The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed.

At the time of acquisition, Rabbit had a development project in process for the Rabbit 4000 microprocessor. The project involved the design and development of a next-generation microprocessor that would have increased code execution speed, reduced code size, added security features, and integrated Ethernet capabilities. Management estimated that $0.3 million of the purchase price represented the fair value of acquired in-process research and development related to the Rabbit 4000 microprocessor that had not yet reached technological feasibility and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company's estimate of revenue growth over the next six fiscal years, or the estimated life cycle of the Rabbit 4000 microprocessor, using the assumption that all revenue recorded after that date will be generated from future technologies.
- The estimated gross margin was based upon historical gross margin for Rabbit's products, with an increase over time attributable to production synergies.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

- The estimated selling, general and administrative expenses were based on consideration of historical operating expenses as a percentage of sales and Rabbit's projected operating expenses.
- The Company believes that projected cash flows for in-process research and development technologies are generally of higher variability and risk than existing technologies and this was considered in determining an appropriate rate of return by which to discount the cash flows generated by in-process research and development.

The Company anticipates that the Rabbit 4000 microprocessor will be released in March 2006. These estimates described above are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur.

GAIN FROM FORGIVENESS OF GRANT PAYABLE

In connection with the acquisition of ITK International, Inc. (ITK) in July 1998, the Company assumed a $1.5 million liability for an investment grant, payable to the German government, related to construction of the ITK facility in Dortmund, Germany. During 2003, the Company recognized a $0.6 million gain from the forgiveness of the investment grant payable as the remaining grant payable was forgiven as a result of the Company remaining in the building through August 2003 (see Note 3 to the Company's Consolidated Financial Statements).

OTHER INCOME (EXPENSE)

Total other income, net was $1.0 million in fiscal 2005 compared to $0.4 million in fiscal 2004. The Company realized interest income on marketable securities and cash and cash equivalents of $1.6 million in fiscal 2005 compared to $0.9 million in fiscal 2004. The increase in interest income was primarily due to higher average interest rates in fiscal 2005 compared to fiscal 2004 while average cash and marketable security balances were comparable between years. Interest expense was $0.1 million in fiscal 2005 primarily related to interest expense on the $21.0 million short-term loan that was used to finance the Rabbit acquisition and interest on capital leases and a revolving line of credit held by Rabbit. The short-term loan was paid in full in July 2005. Other expense was $0.5 million in both fiscal 2005 and fiscal 2004.

Total other income, net was $0.4 million in fiscal 2004 compared to $0.3 million in fiscal 2003. The Company realized interest income on marketable securities and cash and cash equivalents of $0.9 million in both fiscal 2004 and fiscal 2003. Higher average cash and marketable securities balances in fiscal 2004 compared to fiscal 2003 offset the impact of lower average interest rates during comparable periods. The Company paid off all outstanding debt in January 2004 resulting in a $0.5 million decrease in interest expense between years. Other expense was $0.5 million in fiscal 2004 compared to $0.1 million in fiscal 2003. Other expense in fiscal 2003 was partially offset by $0.3 million of income received from the sale of non-core intellectual property.

INCOME TAXES

The Company's effective income tax rate was 1.8% in fiscal 2005 compared to 28.7% in fiscal 2004. In February 2005, the Congressional Joint Committee on Taxation approved a settlement with the Internal Revenue Service on an audit of certain of the Company's prior fiscal years income tax returns. The Company had established tax reserves in excess of the ultimate settled amounts. As a result, the Company recorded an income tax benefit of $5.7 million in fiscal 2005 representing the excess of its income tax reserves over the amount paid. The estimated annual effective rate for fiscal 2005, adjusted for the $5.7 million favorable tax settlement, would have been 33.4%. The effective tax rate for both fiscal 2005 and fiscal 2004 is lower than the

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

INCOME TAXES (CONTINUED)

U.S. statutory rate of 35.0% primarily due to utilization of income tax credits and exclusions for extraterritorial income. The effective tax rate for fiscal 2005, excluding the $5.7 million income tax benefit, is higher than the effective tax rate for fiscal 2004 as a result of higher income before income taxes and cumulative effect of accounting change, lower tax credits and exclusions for extraterritorial income, and non-deductible Rabbit acquisition costs.

The Company's effective income tax rate was (0.3%) in fiscal 2003. The negative effective rate in fiscal 2003 is due to the reversal of the valuation allowance associated with the German net operating loss carryforwards based upon current and anticipated future taxable income generated by the Company's German operations. The portion of the valuation allowance related to the German net operating loss carryforwards that was expected to be utilized by the Company during the year ended September 30, 2003 was accounted for by reducing the effective income tax rate in fiscal 2003. The portion of the valuation allowance related to the German net operating loss carryforwards that was expected to be utilized by the Company during periods subsequent to September 30, 2003 resulted in an income tax benefit of $1.4 million being recorded as a discrete event during fiscal 2003. The effective rate for fiscal 2003, adjusted for the $1.4 million valuation allowance reversal, would have been 21.2%. The tax provision for fiscal 2003, adjusted for the $1.4 million valuation allowance reversal, is recorded at a rate less than the U.S. statutory rate primarily due to an exclusion for extraterritorial income, utilization of income tax credits, and the effect of an increase in acquired deferred tax assets resulting from available NetSilicon net operating losses.

The effective tax rate, excluding the $5.7 million favorable tax settlement in fiscal 2005 and the $1.4 million valuation allowance reversal in fiscal 2003 are not measures of financial performance under generally accepted accounting principles (GAAP). Management believes that excluding these one-time non-recurring items provides useful information to investors regarding the Company's effective tax rate in comparison to the U.S. statutory rate. The reconciliation of this measure to the most directly comparable GAAP financial measure is disclosed in the "Non-GAAP Financial Measures" section of this report.

As of September 30, 2005, the Company had domestic federal net operating loss carryforwards and tax credit carryforwards of approximately $8.5 million and $4.1 million, respectively, which expire at various dates through 2024. All of the $8.5 million of net operating loss carryforwards and approximately $0.8 million of tax credit carryforwards relate to the NetSilicon acquisition and are subject to annual use limitations of $2.8 million, in accordance with provisions of the Internal Revenue Code.

The Company is required to assess the realizability of its deferred tax assets and the need for a valuation allowance against those assets in accordance with Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" (FAS 109). The Company has concluded that it is more likely than not that the remaining deferred tax assets will be realized based on future projected taxable income and the anticipated future reversal of deferred tax liabilities, and therefore no valuation allowance has been established at September 30, 2005. The amount of the net deferred tax assets realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If the Company's future taxable income projections are not realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in future taxable income is determined.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS AND RELATED CHANGE IN ACCOUNTING PRINCIPLE

As discussed more fully in Note 4 to the Company's Consolidated Financial Statements, the Company adopted the provisions of FAS 142 as of October 1, 2002 at which time it was determined that there was a total goodwill impairment of $43.9 million. The Company recorded this charge in the first quarter of fiscal 2003. The charge was attributable to an impairment of the carrying value of goodwill related to three acquisitions, primarily that of NetSilicon. The impairment resulted from significant changes in the Company's expected future cash flows that resulted from a decline in anticipated future revenues due both to the general downturn in the worldwide economy and to a severe downturn in the networking communications and semiconductor industries. As a result of the downturn in expected future revenues and a substantial decline in the Company's market capitalization during 2002, the indicated fair values of the Company's reporting units had declined substantially since the acquisitions. The charge was reported as a cumulative effect of a change in accounting principle. There was no income tax effect associated with this impairment charge.

The Company performed its annual goodwill impairment assessment as of June 30, 2005 and 2004. A discounted cash flow technique was utilized in determining the fair value of each reporting unit. Since the calculated fair value of each reporting unit exceeded book value, there was no impairment identified. Goodwill of $38.7 million is recorded on the Company's balance sheet as of September 30, 2005.

INFLATION

Management believes inflation has not had a material effect on the Company's operations or on its financial position.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations. At September 30, 2005, the Company had cash, cash equivalents and short-term marketable securities of $50.2 million compared to $79.2 million at September 30, 2004. The Company's working capital decreased $12.1 million to $70.0 million at September 30, 2005, compared to $82.1 million at September 30, 2004. Working capital increased $24.3 million in fiscal 2004 from $57.8 million at September 30, 2003 to $82.1 million at September 30, 2004.

Net cash provided by operating activities was $18.1 million during fiscal 2005 compared to net cash provided by operating activities of $19.3 million during fiscal 2004. The decline in net cash provided by operating activities of $1.2 million between comparable fiscal years ended September 30, 2005 and 2004 is primarily the result of a payment of $3.2 million to the IRS in November 2004 due to the settlement on an audit of certain of the Company's income tax returns for prior fiscal years. Net cash provided by operating activities was $19.3 million during fiscal 2004 compared to net cash provided by operating activities of $15.8 million during fiscal 2003. Fiscal 2004 net income of $8.7 million along with non-cash charges including depreciation and amortization expense of $8.6 million and a $2.3 million tax benefit related to stock options exercises were the primary factors that resulted in net cash provided by operating activities of $19.3 million. Net cash provided by operating activities totaled $15.8 million during fiscal 2003. Non-cash charges including a goodwill impairment charge of $43.9 million, depreciation and amortization expense of $10.3 million and a provision for inventory obsolescence of $1.2 million reduced the effect of the fiscal 2003 net loss of $37.2 million.

Net cash used in investing activities was $30.1 million during fiscal 2005 compared to net cash used in investing activities of $25.0 million and $19.5 million during fiscal 2004 and fiscal 2003, respectively. During fiscal 2005, the Company paid $48.9 million and $4.8 million for the acquisitions of Rabbit and FS Forth, respectively. Net settlements from marketable securities were $25.0 million in fiscal 2005 compared to net

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

purchases of $21.7 million and $15.7 million in fiscal 2004 and fiscal 2003, respectively. Purchases of property, equipment, improvements and certain other intangible assets were $1.3 million in both fiscal 2005 and fiscal 2004 and $1.7 million in fiscal 2003. The Company also used $2.0 million in fiscal 2004 and 2003 for contingent purchase price payments related to acquisitions.

The Company generated $4.9 million from financing activities in fiscal 2005, compared to $7.1 million in fiscal 2004, primarily due to cash received from the exercise of stock option and employee stock purchase plans of $6.3 million and $9.3 million in fiscal 2005 and 2004, respectively. The Company entered into a $21.0 million short-term loan during the third quarter of fiscal 2005 to finance the Rabbit acquisition. The Company determined that it was more economical to borrow funds to finance the Rabbit acquisition than to liquidate marketable securities prior to their scheduled maturities. This short-term loan was repaid in fiscal 2005.

During fiscal 2003, the Company used $12.5 million for financing activities, primarily due to the use of $8.6 million to repurchase 2,324,683 shares of its common stock from Sorrento Networks Corporation. Additionally, the Company elected to pay the remaining $5.8 million of long-term debt obligations originally scheduled to be paid in semi-annual principal installments through December 30, 2017. These payments in fiscal 2003 were partially offset by borrowings under a new short-term borrowing agreement with Sparkasse Dortmund in the amount of $2.0 million. This borrowing was repaid in January 2004.

The Company's management believes that current financial resources, cash generated from operations and the Company's potential capacity for debt and/or equity financing will be sufficient to fund its business operations for the foreseeable future.

The following summarizes the Company's contractual obligations at September 30, 2005. However, this table excludes up to $2.0 of additional purchase consideration that may be payable to FS Forth in installments of $0.8 million on October 1, 2006 and $1.2 million on October 1, 2007 if FS Forth achieves certain future milestones.

	Payments due by fiscal period				
in thousands)	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Operating leases	$ 6,161	$ 1,879	$ 2,439	$ 856	$ 987
Short-term loan	1	1	—	—	—
Capital leases	1,594	413	796	385	—
Total contractual cash obligations	$ 7,756	$ 2,293	$ 3,235	$ 1,241	$ 987

The lease obligations summarized above relate to various operating lease agreements for office space and equipment and have not been reduced by minimum sublease rentals of $0.2 million due in the future under noncancellable subleases.

FOREIGN CURRENCY

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

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

FOREIGN CURRENCY (CONTINUED)

During 2005, the Company had approximately $53.2 million of net sales related to foreign customers including export sales, of which $18.6 million was denominated in foreign currency, predominantly the Euro. During 2004 and 2003, the Company had approximately $49.2 million and $36.5 million, respectively, of net sales to foreign customers including export sales, of which $15.8 million and $12.0 million, respectively were denominated in foreign currency, predominately the Euro. In future periods, a significant portion of sales will continue to be made in Euros.

RECENT ACCOUNTING DEVELOPMENTS

In December 2004, the FASB issued FAS 123R which replaces FAS 123 and supersedes APB 25. This standard requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Under this statement, the Company must measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award and the cost must be recognized over the period during which an employee is required to provide the service (usually the vesting period). In April 2005 the SEC delayed the effective date of FAS 123R and as a result, the Company has adopted the provisions of this standard beginning October 1, 2005. The Company expects that the standard will result in an increase in compensation expense which will result in a reduction to net income and net income per common share. The adoption of this standard is expected to have a material effect on the Company's consolidated results of operations (see Note 1 to the Company's Consolidated Financial Statements).

CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company 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. The Company bases its 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.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

REVENUE RECOGNITION

The Company's revenues are derived primarily from the sale of products to its distributors and OEM customers, and to a lesser extent from the sale of software licenses, fees associated with technical support, training, professional and engineering services, and royalties. The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collectibility is reasonably assured and there are no post-delivery obligations other than warranty. Under these criteria, product revenue is generally recognized upon shipment of product to customers. Sales to authorized domestic distributors and OEMs are made with certain rights of return and price adjustment provisions. Estimated reserves for future returns and pricing adjustments are established by the Company based on an analysis of historical patterns of returns and price adjustments as well as an analysis of authorized returns compared to received returns, current on-hand inventory at distributors, and distribution sales for the current

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

CRITICAL ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION (CONTINUED)

period. Estimated reserves for future returns and price adjustments are charged against revenues in the same period as the corresponding sales are recorded. Material differences between the historical trends used to determine estimated reserves and actual returns and pricing adjustments could result in a material change to the Company's consolidated results of operations or financial position. The Company has applied consistent methodologies for estimating reserves for future returns and pricing adjustments for all years presented. The reserve for future returns and pricing adjustments was $1.8 million at September 30, 2005 compared to $2.0 million at September 30, 2004.

In fiscal 2004 and fiscal 2003 the Company offered rebates to authorized domestic distributors. No such rebates were offered in fiscal 2005. The rebates were incurred based on key metrics and the level of sales the respective distributors made to end user customers and were charged to operations as a reduction in revenue in the same period as the corresponding sales.

The Company also generates revenue from the sale of software and licenses, post-contract customer support, fees associated with technical support, training, professional and engineering services, and royalties. Revenue recognized resulting from such non-product sales represented 1.3% of net sales in fiscal 2005, 2.6% of net sales in fiscal 2004, and 2.1% of net sales in fiscal 2003. The Company's software development tools and developments boards often include multiple elements, including hardware, software and licenses, post-contract customer support, limited training and basic hardware design review. The Company's customers purchase these products and services during their product development process in which they use the tools to build network connectivity into the devices they are manufacturing. Revenue for software licenses and professional and engineering services is recognized upon performance, which includes delivery of a final product version and acceptance by the customer. For post-contract support and fees associated with technical support, revenue is deferred and recognized over the life of the contract as service is performed. Royalty revenue is recognized when cash is received from the customer. Unearned post-contract customer support and unearned nonrecurring engineering services revenue is included in deferred revenue on the balance sheet.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company maintains an allowance for doubtful accounts, which reflects the estimate of losses that may result from the inability of some of the Company's customers to make required payments. The estimate for the allowance for doubtful accounts is based on known circumstances regarding collectibility of customer accounts and historical collections experience. If the financial condition of one or more of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Material differences between the historical trends used to estimate the allowance for doubtful accounts and actual collection experience could result in a material change to the Company's consolidated results of operations or financial position. As of September 30, 2005 the allowance for doubtful accounts was $0.9 million compared to $1.0 million at September 30, 2004.

INVENTORY

Inventories are stated at the lower of cost or fair market value, with cost determined using the first-in, first-out method. The Company reduces the carrying value of its inventories for estimated excess and obsolete inventories equal to the difference between the cost of inventory and its estimated realizable value based upon assumptions about future product demand and market conditions. If actual product demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

CRITICAL ACCOUNTING POLICIES (CONTINUED)

INVENTORY (CONTINUED)

required that could result in a material change to the Company's consolidated results of operations or financial position. The Company has applied consistent methodologies for the net realizable value of inventories. The reserve for excess and obsolete inventory was $1.6 million and $2.4 million at September 30, 2005 and 2004, respectively.

IDENTIFIABLE INTANGIBLE ASSETS

Purchased proven technology, customer relationships, license agreements, covenants not to compete and other identifiable intangible assets are recorded at fair value when acquired in a business acquisition, or at cost when not purchased in a business combination. Purchased in-process research and development costs (IPR&D) are expensed upon consummation of the related business acquisition. All other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives of three to thirteen years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets. Methods of amortization reflect the pattern in which the asset is consumed.

In accordance with FAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144), identifiable intangible assets are reviewed at least annually for impairment, or whenever events or circumstances indicate that the asset's undiscounted expected future cash flows are not sufficient to recover the carrying value amount. The Company measures impairment loss by utilizing an undiscounted cash flow valuation technique using fair values indicated by the income approach. Impairment losses, if any, are recorded currently. To the extent that the Company's undiscounted future cash flows were to decline substantially, such an impairment charge could result.

There are certain assumptions inherent in projecting the recoverability of the Company's identifiable intangible assets. If actual experience differs from the assumptions made the consolidated results of operations or financial position of the Company could be materially impacted.

GOODWILL

Goodwill represents the excess of cost over the fair value of identifiable assets acquired and is not amortized. However, in accordance with FAS No. 142, goodwill is subject to an impairment assessment at least annually which may result in a charge to operations if the fair value of the reporting unit in which the goodwill is reported declines. There are certain assumptions inherent in projecting the fair value of goodwill. Significant assumptions include the Company's estimates of future cash flows and the cost of capital. These and other estimates are based upon information that the Company uses to prepare its annual and five year business plan projections. If actual experience differs from the assumptions made the consolidated results of operations or financial position of the Company could be materially impacted.

The Company performed its annual goodwill impairment assessment as of June 30, 2005 utilizing a discounted cash flow technique and determined that there was no impairment. Goodwill of $38.7 million is recorded on the Company's consolidated balance sheet as of September 30, 2005. (See Note 4 to the Company's Consolidated Financial Statements).

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

CRITICAL ACCOUNTING POLICIES (CONTINUED)

INCOME TAXES

Deferred tax assets and liabilities are recorded based on FAS 109. The amount of deferred tax assets and liabilities actually realized could be impacted by differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If management determines that it is more likely than not that a deferred tax asset will not be realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in estimated future taxable income is determined. The Company has determined that a valuation allowance is not required as of September 30, 2005.

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

The Company operates in multiple tax jurisdictions both in the U.S. and outside of the U.S. Accordingly, the Company must determine the appropriate allocation of income to each of these jurisdictions. This determination requires the Company to make several estimates and assumptions. Tax audits associated with the allocation of this income, and other complex issues, may require an extended period of time to resolve and could result in adjustments to the Company's income tax balances that are material to the consolidated financial position and results of operations. During fiscal 2005, the Company adjusted its income tax reserves by $5.7 million following a settlement with the Internal Revenue Service (See Note 10 to the Company's Consolidated Financial Statements).

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

The Company's exposure to interest rate risk relates primarily to the Company's investment portfolio. Investments are made in accordance with the Company's investment policy and consist of high grade commercial paper and corporate bonds. The Company does not use derivative financial instruments to hedge against interest rate risk as all investments are held to maturity and the majority of the Company's investments mature in less than a year.

FOREIGN CURRENCY RISK

The Company is exposed to foreign currency transaction risk associated with certain sales transactions being denominated in Euros or Japanese Yen and foreign currency translation risk as the financial position and operating results of the Company's foreign subsidiaries are translated into U.S. Dollars for consolidation. The Company has not implemented a hedging strategy to reduce foreign currency risk.

During 2005, the average monthly exchange rate for the Euro to the U.S. Dollar increased by approximately 4.6% from 1.2166 to 1.2724 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar increased by approximately 1.6% from .0092 to .0093. A 10.0% change from the 2005 average exchange rate for the Euro and Yen to the U.S. Dollar would have resulted in a 1.5% increase or decrease in annual net sales and a 1.2% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments the Company may need to consider in response to changes in the exchange rate.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (CONTINUED)

CREDIT RISK

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have completed an integrated audit of Digi International Inc's 2005 consolidated financial statements and of its internal control over financial reporting as of September 30, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows, and of stockholders' equity and comprehensive income (loss) present fairly, in all material respects, the financial position of Digi International Inc. and its subsidiaries at September 30, 2005 and 2004 and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 4, the Company adopted the provisions of Financial Accounting Standards Board No. 142, "Goodwill and Other Intangible Assets," effective October 1, 2002.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of September 30, 2005 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2005, based on criteria established in *Internal Control – Integrated Frame*work issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM (CONTINUED)

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Report on Internal Control over Financial Reporting, management has excluded Rabbit Semiconductor Inc. (Rabbit) and FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (collectively FS Forth), from its assessment of internal control over financial reporting as of September 30, 2005 because they were acquired by the Company in purchase business combinations during 2005. We have also excluded Rabbit and FS Forth from our audit of internal control over financial reporting. Rabbit and FS Forth total assets represented 34.2% and 3.1%, respectively, of total consolidated assets as of September 30, 2005 and Rabbit and FS Forth total net sales represented 8.5% and 2.1%, respectively, of the total consolidated net sales for the year ended September 30, 2005.

/s/ PricewaterhouseCoopers LLP
Minneapolis, Minnesota
December 6, 2005

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

DIGI INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per common share data)

For the fiscal years ended September 30,	2005	2004	2003
Net sales	$ 125,198	$ 111,226	$ 102,926
Cost of sales	49,516	43,443	41,580
Gross profit	75,682	67,783	61,346
Operating expenses:			
Sales and marketing	26,339	25,556	24,734
Research and development	16,531	17,159	15,968
General and administrative	15,555	13,287	15,524
Restructuring	—	—	(600)
Acquired in-process research & development	300	—	—
Total operating expenses	58,725	56,002	55,626
Gain from forgiveness of grant payable	—	—	553
Operating income	16,957	11,781	6,273
Other income (expense):			
Interest income	1,581	856	899
Interest expense	(104)	(19)	(539)
Other expense	(451)	(468)	(64)
Total other income, net	1,026	369	296
Income before income taxes and cumulative effect of accounting change	17,983	12,150	6,569
Income tax provision (benefit)	318	3,487	(23)
Income before cumulative effect of accounting change	17,665	8,663	6,592
Cumulative effect of accounting change	—	—	(43,866)
Net income (loss)	$ 17,665	$ 8,663	$ (37,274)
Net income (loss) per common share, basic:			
Income before cumulative effect of accounting change	$ 0.79	$ 0.41	$ 0.31
Cumulative effect of accounting change	—	—	(2.08)
Net income (loss) per common share	$ 0.79	$ 0.41	$ (1.77)
Net income (loss) per common share, diluted:			
Income before cumulative effect of accounting change	$ 0.76	$ 0.39	$ 0.31
Cumulative effect of accounting change	—	—	(2.07)
Net income (loss) per common share	$ 0.76	$ 0.39	$ (1.76)
Weighted average common shares, basic	22,450	21,196	21,029
Weighted average common shares, diluted	23,371	22,031	21,151

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

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

DIGI INTERNATIONAL INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

As of September 30,	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 12,990	$ 19,528
Marketable securities	37,184	59,639
Accounts receivable, net	16,897	10,555
Inventories	18,527	11,231
Deferred tax assets, current	2,892	2,794
Other	2,223	1,521
Total current assets	90,713	105,268
Marketable securities, long-term	—	2,500
Property, equipment and improvements, net	20,808	18,634
Identifiable intangible assets, net	26,342	14,417
Goodwill	38,675	5,816
Net deferred tax assets	—	3,013
Other	1,093	817
Total assets	$ 177,631	$ 150,465
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Capital lease obligations, current portion, and short-term borrowings	$ 414	$ —
Accounts payable	6,272	4,765
Income taxes payable	3,306	9,107
Accrued expenses:		
Compensation	5,308	5,019
Other	5,048	3,391
Deferred revenue	370	896
Total current liabilities	20,718	23,178
Capital lease obligations, net of current portion	1,181	—
Net deferred tax liabilities	2,195	208
Total liabilities	24,094	23,386
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued and outstanding	—	—
Common stock, $.01 par value; 60,000,000 shares authorized; 25,456,755 and 24,678,496 shares issued	255	247
Additional paid-in capital	136,513	128,538
Retained earnings	35,896	18,231
Accumulated other comprehensive income	639	333
Treasury stock, at cost, 2,794,562 and 2,865,907 shares	(19,766)	(20,270)
Total stockholders' equity	153,537	127,079
Total liabilities and stockholders' equity	$ 177,631	$ 150,465

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

DIGI INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

For the fiscal years ended September 30,	2005	2004	2003
Operating activities:			
Net income (loss)	$ 17,665	$ 8,663	$ (37,274)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of property, equipment and improvements	2,295	2,432	3,131
Amortization of identifiable intangible assets and other assets	6,575	6,165	7,172
Bad debt and product return recoveries	(820)	(453)	(134)
Provision for inventory obsolescence	76	—	1,248
Tax benefit related to the exercise of stock options	2,113	2,274	25
Cumulative effect of accounting change	—	—	43,866
Deferred income taxes	1,052	1,448	(2,598)
Restructuring	—	—	(600)
Gain from forgiveness of grant payable	—	—	(553)
Acquired in-process research & development	300	—	—
Other	54	134	95
Changes in operating assets and liabilities, net of acquisition impact:			
Accounts receivable	(2,730)	926	482
Inventories	(602)	(790)	835
Other assets	(736)	(286)	453
Income taxes payable	(7,039)	(510)	4,702
Accounts payable	863	(1,326)	(1,366)
Accrued expenses	(1,010)	644	(3,697)
Total adjustments	391	10,658	53,061
Net cash provided by operating activities	18,056	19,321	15,787
Investing activities:			
Purchase of held-to-maturity marketable securities	(48,943)	(129,983)	(61,301)
Proceeds from maturities of held-to-maturity marketable securities	73,898	108,249	45,557
Purchase of property, equipment, improvements and certain other intangible assets	(1,329)	(1,293)	(1,691)
Contingent purchase price payments related to business acquisitions	—	(1,961)	(2,018)
Acquisition of Rabbit Semiconductor, Inc., net of cash acquired	(48,934)	—	—
Acquisition of FS Forth-Systeme GmbH and Sistemas Embebidos S.A., net of cash acquired	(4,759)	—	—
Net cash used in investing activities	(30,067)	(24,988)	(19,453)
Financing activities:			
Net (payments) borrowing on short-term borrowing and line of credit	(1,274)	(2,149)	1,983
Payments on capital lease obligations and long-term debt	(152)	—	(6,788)
Borrowing on note payable	21,000	—	—
Payment on note payable	(21,000)	—	—
Proceeds from stock option plan transactions	5,600	8,587	307
Proceeds from employee stock purchase plan transactions	721	668	577
Purchase of treasury stock	—	—	(8,554)
Net cash provided by (used in) financing activities	4,895	7,106	(12,475)
Effect of exchange rates changes on cash and cash equivalents	578	861	(121)
Net (decrease) increase in cash and cash equivalents	(6,538)	2,300	(16,262)
Cash and cash equivalents, beginning of period	19,528	17,228	33,490
Cash and cash equivalents, end of period	$ 12,990	$ 19,528	$ 17,228
Supplemental Cash Flows Information:			
Interest paid	$ 104	$ 19	$ 625
Income taxes paid (received), net	$ 4,312	$ 184	$ (2,275)
Other non-cash financing items:			
Assumption of line of credit related to acquisition	$ 1,275	$ —	$ —
Assumption of capital leases related to acquisition	$ 1,746	$ —	$ —

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

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

DIGI INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
(in thousands)

For the years ended September 30, 2005, 2004 and 2003

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Unearned Stock Compen-sation	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Par Value	Shares	Value					
Balances, September 30, 2002	23,154	$231	926	$(15,500)	$120,004	$ 46,842	$(327)	$ (71)	$151,179
Net loss						(37,274)			(37,274)
Foreign currency translation adjustment								(495)	(495)
Total comprehensive income (loss)									(37,769)
Employee stock purchase issuances			(281)	3,049	(2,472)				577
Stock compensation expensed							98		98
Issuance of stock upon exercise of stock options	58	1			306				307
Tax benefit realized upon exercise of stock options					25				25
Forfeiture of stock options					(143)		143		—
Purchase of shares from Sorrento Networks Corporation			2,325	(8,554)					(8,554)
Balances, September 30, 2003	23,212	232	2,970	(21,005)	117,720	9,568	(86)	(566)	105,863
Net income						8,663			8,663
Foreign currency translation adjustment								899	899
Total comprehensive income									9,562
Employee stock purchase issuances			(104)	735	(67)				668
Stock compensation expensed							80		80
Issuance of stock upon exercise of stock options	1,466	15			8,572				8,587
Tax benefit realized upon exercise of stock options					2,274				2,274
Forfeiture of stock options					(6)		6		—
Stock options issued to non-employees					45				45
Balances, September 30, 2004	24,678	247	2,866	(20,270)	128,538	18,231	—	333	127,079
Net income						17,665			17,665
Foreign currency translation								306	306

adjustment									
Total comprehensive income									17,971
Employee stock purchase issuances			(71)	504	217				721
Issuance of stock upon exercise of stock options	779	8			5,592				5,600
Tax benefit realized upon exercise of stock options					2,113				2,113
Stock options issued to non-employees					53				53
Balances, September 30, 2005	25,457	$255	2,795	$(19,766)	$136,513	$ 35,896	$ —	$ 639	$153,537

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS DESCRIPTION

Digi is a worldwide leader in "Connectware" and makes device networking easy by developing products and technologies that are cost effective and easy to use. Businesses use Digi products to create, customize and control retail operations, industrial automation and other applications.

Digi's products are sold globally through distributors, systems integrators, solution providers and direct marketers as well as direct to strategic OEMs, government and commercial partners.

PRINCIPLES OF CONSOLIDATION

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

CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Investments with original maturities in excess of three months are classified as marketable securities. Marketable securities consist of high-grade commercial paper and corporate bonds. All marketable securities are classified as held-to-maturity and are carried at amortized cost. Gross unrealized holding losses were $144,312 and $318,360 as of September 30, 2005 and 2004, respectively. Because the Company intends to hold all marketable securities until maturity, realization of the unrealized holding loss at September 30, 2005 is not likely, and therefore not recorded.

CONCENTRATION OF CREDIT RISK

Financial instruments that may subject the Company to significant concentrations of credit risk consist primarily of trade receivables. Creditworthiness and account payment status is routinely monitored and collateral is not required. The Company maintains an allowance for doubtful accounts, which reflects the estimate of losses that may result from the inability of some of the Company's customers to make required payments. The estimate for the allowance for doubtful accounts is based on known circumstances regarding collectibility of customer accounts and historical collections experience.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist primarily of cash equivalents, marketable securities, trade accounts receivable and accounts payable for which current carrying amounts approximate fair market value.

INVENTORIES

Inventories are stated at the lower of cost or fair market value, with cost determined using the first-in, first-out method. Appropriate consideration is given to deterioration, obsolescence and other factors in evaluating fair market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY, EQUIPMENT AND IMPROVEMENTS

Property, equipment and improvements are carried at cost, net of accumulated amortization. Depreciation is provided by charges to operations using the straight-line method over their estimated useful lives. Furniture and fixtures and other equipment are depreciated over a period of three to five years. Building improvements and buildings are depreciated over ten and thirty-nine years, respectively. Property and equipment under capital lease, which consists of equipment, are depreciated over the lease term. Periodic reviews for impairment of the carrying value of property, equipment and improvements are made based on undiscounted expected future cash flows. The Company owns and occupies three buildings located in Minnetonka and Eden Prairie, Minnesota and Dortmund, Germany. The Company is attempting to sell the building in Dortmund, Germany.

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

IDENTIFIABLE INTANGIBLE ASSETS

Purchased proven technology, license agreements, covenants not to compete and other identifiable intangible assets are recorded at fair value when acquired in a business acquisition, or at cost when not purchased in a business acquisition. Purchased IPR&D are expensed upon consummation of the related business acquisition. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the identifiable intangible assets and range from three to thirteen years. Methods of amortization reflect the pattern in which the asset is consumed. To date, all of the Company’s identifiable intangible assets are being amortized on a straight-line basis. Amortization of acquired identifiable intangible assets is charged to operating expense as a component of general and administrative expense.

In accordance with Statement of Financial Accounting Standard No. 144 “Accounting for the Impairment or Disposal of Long-Lived Assets,” (FAS 144) identifiable intangible assets are reviewed at least annually for impairment, or whenever events or circumstances indicate that undiscounted expected future cash flows are not sufficient to recover the carrying value amount. The Company measures impairment loss by utilizing an undiscounted cash flow valuation technique using fair values indicated by the income approach. Impairment losses, if any, are recorded currently. No impairment was identified during fiscal 2005.

GOODWILL

Goodwill represents the excess of cost over the fair value of identifiable assets acquired. The Company adopted the provisions of Statement of Financial Accounting Standard No. 142 “Goodwill and Other Intangible Assets” (FAS 142) as of October 1, 2002 (see Note 4). Goodwill is subject to an impairment assessment, using a discounted cash flow technique by reporting unit, at least annually which may result in a charge to operations if the fair value of the reporting unit in which the goodwill is reported declines. The Company performed its annual goodwill impairment assessment as of June 30, 2005 utilizing a discounted cash flow technique. Since the calculated fair value of each reporting unit exceeded book value, there was no impairment identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

STOCK REPURCHASES

From time to time, the Board of Directors authorizes the Company to repurchase common stock when market conditions are favorable or when a strategic opportunity exists. The Company has outstanding a Board of Directors authorization to repurchase up to 1,000,000 shares of its common stock. During fiscal 2003, the Company repurchased 2,324,683 common shares from Sorrento Networks Corporation at a cost of $8.6 million.

REVENUE RECOGNITION

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104 “Revenue Recognition in Financial Statements” (SAB 104), Statement of Financial Accounting Standards No. 48 “Revenue Recognition when the Right of Return Exists” (FAS 48), Statement of Position No. 97-2 “Software Revenue Recognition” (SOP 97-2), as amended by SOP 98-4 “Deferral of the Effective Date of Certain Provisions of SOP No. 97-2”, SOP 81-1 “Accounting for Performance of Construction-Type and Certain Production-Type Contracts”, and Emerging Issues Task Force (EITF) 00-21 “Revenue Arrangements with Multiple Deliverables”.

Revenue recognized for hardware product sales was 98.7% of net sales in fiscal 2005, 97.4% of net sales in fiscal 2004, and 97.9% of net sales in fiscal 2003. The Company recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, collectibility is reasonably assured and there are no post-delivery obligations, other than warranty. Under these criteria, product revenue is generally recognized upon shipment of product to customers, including OEMs, distributors and other strategic end user customers. Sales to authorized domestic distributors and OEMs are made with certain rights of return and price adjustment provisions. Estimated reserves for future returns and pricing adjustments are established by the Company based on an analysis of historical patterns of returns and price adjustments as well as an analysis of authorized returns compared to received returns, current on-hand inventory at distributors, and distribution sales for the current period. Estimated reserves for future returns and price adjustments are charged against revenues in the same period as the corresponding sales are recorded. In fiscal 2004 and fiscal 2003 the Company offered rebates to authorized domestic distributors. No such rebates were offered in fiscal 2005. The rebates were incurred based on key metrics and the level of sales the respective distributors made to end user customers and was charged to operations as a reduction in revenue in the same period as the corresponding sales.

The Company also generates revenue from the sale of software and licenses, post-contract customer support, fees associated with technical support, training, professional and engineering services, and royalties. Revenue recognized from such non-product sales represented 1.3% of net sales in fiscal 2005, 2.6% of net sales in fiscal 2004, and 2.1% of net sales in fiscal 2003. These non-product arrangements often contain multiple elements. The Company recognizes revenue related to multiple element arrangements resulting in the allocation of revenue to the various elements within the arrangement based upon vendor-specific objective evidence of fair value as determined by the price charged for each element when sold separately. The Company’s software development tools and development boards often include multiple elements including hardware, software and licenses, post-contract customer support, limited training and basic hardware design review. The Company’s customers purchase these products and services during their product development process in which they use the tools to build network connectivity into the devices they are manufacturing.

Nonrecurring engineering services are a type of multiple element. Revenue recognized pertaining to nonrecurring engineering services was 0.6% of net sales in fiscal 2005, 1.3% of net sales in fiscal 2004, and 1.2% of net sales in fiscal 2003. As these contracts often involve product customization, they generally do not meet the criteria for separate accounting and thus the related revenue is recognized using contract accounting,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION (CONTINUED)

and revenue is recognized upon completion of the contract or percentage-of-completion method. Contract completion is often accompanied by delivery of a final product version and acceptance by the customer. The percentage-of-completion method is based on the ratio of actual labor hours incurred to total estimated labor hours for the individual contract. The Company defers revenues from nonrecurring engineering services until delivery if, at the inception of the arrangement, there is uncertainty about delivery and/or the costs of delivery cannot be accurately estimated. Revenue from post-contract customer support obligations is deferred and recognized at the time the service is provided or over the life of the underlying service or support contract, if applicable. Unearned post-contract customer support and unearned nonrecurring engineering services revenue is included in deferred revenue on the balance sheet.

RESEARCH AND DEVELOPMENT

Research and development costs are expensed when incurred. Software development costs are expensed as incurred until the point that technological feasibility and proven marketability of the product are established. Software development costs, otherwise capitalized after such point, also are expensed because they are insignificant. Research and development costs include compensation, allocation of corporate costs, depreciation, professional services and prototypes.

INCOME TAXES

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities. Tax credits are accounted for under the flow-through method, which recognizes the benefit in the year in which the credit is utilized.

NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is calculated based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common and common equivalent shares outstanding during the period. The Company’s only potentially dilutive common shares are those that result from dilutive common stock options and shares purchased through the employee stock purchase plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NET INCOME (LOSS) PER COMMON SHARE (CONTINUED)

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

Years ended September 30,	2005	2004	2003
Numerator:			
Net income (loss)	$ 17,665	$ 8,663	$ (37,274)
Denominator:			
Denominator for basic net income (loss) per common share — weighted average shares outstanding	22,450	21,196	21,029
Effect of dilutive securities:			
Employee stock options and employee stock purchase plan	921	835	122
Denominator for diluted net income (loss) per common share — adjusted weighted average shares	23,371	22,031	21,151
Basic net income (loss) per common share	$ 0.79	$ 0.41	$ (1.77)
Diluted net income (loss) per common share	$ 0.76	$ 0.39	$ (1.76)

Stock options to purchase 720,875, 2,053,609 and 5,170,699 common shares at September 30, 2005, 2004 and 2003, respectively, were not included in the computation of diluted earnings per common share because the options' exercise prices were greater than the average market price of common shares and, therefore, their effect would be antidilutive whether or not the Company generated net income.

Pursuant to Statement of Financial Accounting Standards No. 128, "Earnings per Share," income before cumulative effect of accounting change has been used in determining diluted earnings per common share for the year ended September 30, 2003.

STOCK-BASED COMPENSATION

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

STOCK-BASED COMPENSATION (CONTINUED)

Had the Company applied the fair-value-based method of accounting for its stock options granted to employees and for the stock purchases under the employee stock purchase plan and charged operations over the option vesting periods based on the fair value of options on the date of grant, net income and net income per common share would have changed to the pro forma amounts indicated below (in thousands, except per common share data):

Years ended September 30,	2005	2004	2003
Net income (loss) as reported	$ 17,665	$ 8,663	$ (37,274)
Add: Total stock-based compensation expense included in reported net income (loss), net of related tax effects	35	89	78
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,363)	(2,338)	(2,607)
Pro forma net income (loss)	$ 16,337	$ 6,414	$ (39,803)
Net income (loss) per common share:			
Basic — as reported	$ 0.79	$ 0.41	$ (1.77)
Basic — pro forma	$ 0.73	$ 0.30	$ (1.89)
Diluted — as reported	$ 0.76	$ 0.39	$ (1.76)
Diluted — pro forma	$ 0.70	$ 0.29	$ (1.88)

The weighted average fair value of options granted and assumed in fiscal years 2005, 2004 and 2003 was $6.35, $5.07 and $1.75, respectively. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

	2005	2004	2003
Assumptions:			
Risk free interest rate	3.52%	2.86%	2.13%
Expected option holding period	3.9 years	3.6 years	2.8 years
Expected volatility	60%	70%	75%
Expected dividend yield	0	0	0

In December 2004, the Financial Accounting Standards Board issued Statement No. 123 (revised 2004), “Share-Based Payment” (FAS 123R) which revises FAS 123 and supersedes APB 25. This standard requires the recognition of the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. Under this statement, the Company must measure the cost of employee services received in exchange for an award of equity instruments based upon the fair value of the award on the date of grant. This cost must be recognized over the period during which an employee is required to provide the service (usually the vesting period). In April 2005 the SEC delayed the effective date of FAS 123R and as a result, the Company has adopted the provisions of this standard beginning October 1, 2005. The adoption of this standard will result in an increase in compensation expense and a reduction to net income and net income per common share. As indicated by the pro forma

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

STOCK-BASED COMPENSATION (CONTINUED)

amounts in the above table, the adoption of this standard is expected to have a material effect on the Company's consolidated results of operations.

FOREIGN CURRENCY TRANSLATION

Financial position and results of operations of the Company's international subsidiaries are measured using local currencies as the functional currency. Assets and liabilities of these operations are translated at the exchange rates in effect at each fiscal year-end. Statements of operations accounts are translated at the average rates of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income (loss) in stockholders' equity. The Company has not implemented a hedging strategy to reduce the risk of foreign currency translation exposures.

USE OF ESTIMATES AND RISKS AND UNCERTAINTIES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

COMPREHENSIVE INCOME (LOSS)

For the Company, comprehensive income (loss) is comprised of net income (loss) and foreign currency translation adjustments. Foreign currency translation adjustments are charged or credited to the accumulated other comprehensive income (loss) account in stockholders' equity.

2. ACQUISITIONS

Rabbit Semiconductor Inc.

On May 26, 2005, the Company acquired Rabbit Semiconductor Inc. (Rabbit), formerly Z-World, Inc., a privately held corporation for a purchase price of $49.3 million in cash (excluding cash acquired of $0.4 million and assumption of $1.3 million of debt) in exchange for all outstanding shares of Rabbit's common stock and outstanding stock options. The Company did not replace Rabbit's outstanding options with Digi options.

The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in goodwill of $30.6 million. The Company believes that the acquisition resulted in the recognition of goodwill primarily because the complementary nature of Rabbit microprocessor and microprocessor-based modules, and Z-World single board computer product lines are anticipated to extend Digi's position in the commercial device networking module business. The Company has determined that Rabbit's products are part of the Device Networking Solutions segment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. ACQUISITIONS (CONTINUED)

Rabbit's operating results are included in the Company's consolidated results of operations from the date of acquisition. The consolidated balance sheet as of September 30, 2005 reflects the allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The table below sets forth the final purchase price allocation (in thousands):

Cash	$ 49,000
Direct acquisition costs	287
	$ 49,287

Fair value of net tangible assets acquired	$ 8,766
Identifiable intangible assets:	
Purchased and core technology	8,700
Customer relationships	4,400
Patents and trademarks	2,600
In-process research and development	300
Goodwill	30,644
Deferred tax liabilities related to identifiable intangibles	(6,123)
	$ 49,287

The purchased and core technology identified above have useful lives ranging between five to seven years, customer relationships have useful lives of nine years, and patents and trademarks have useful lives between ten to thirteen years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects 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 asset is consumed.

At the time of acquisition, Rabbit had a development project in process for the Rabbit 4000 microprocessor. The project involved the design and development of a next-generation microprocessor that would have increased code execution speed, reduced code size, added security features, and integrated Ethernet capabilities. Management estimated that $0.3 million of the purchase price represented the fair value of acquired in-process research and development related to the Rabbit 4000 microprocessor that had not yet reached technological feasibility and had no alternative future uses. This amount was expensed as a non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the income valuation approach to determine the estimated fair value of the acquired in-process research and development. These estimates were based on the following assumptions:

- The estimated revenues were based upon the Company's estimate of revenue growth over the next six fiscal years, or the estimated life cycle of the Rabbit 4000 microprocessor, using the assumption that all revenue recorded after that date will be generated from future technologies.
- The estimated gross margin was based upon historical gross margin for Rabbit's products, with an increase over time attributable to production synergies.
- The estimated selling, general and administrative expenses were based on consideration of historical operating expenses as a percentage of sales and Rabbit's projected operating expenses.
- The Company believes that projected cash flows for in-process research and development technologies are generally of higher variability and risk than existing technologies and this was considered in determining an appropriate rate of return by which to discount the cash flows generated by in-process research and development.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. ACQUISITIONS (CONTINUED)

The Company anticipates that the Rabbit 4000 microprocessor will be released in March 2006. These estimates described above are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur.

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisition of Rabbit had occurred as of the beginning of fiscal 2004. Pro forma adjustments include amortization of identifiable intangible assets. The pro forma net income for the year ended September 30, 2005 includes the $0.3 million charge related to acquired in-process research and development associated with the Rabbit acquisition.

(in thousands, except per common share amount)

	Year ended September 30,	
	2005	2004
Net sales	$146,289	$138,520
Net income	15,629	7,699
Net income per common share, basic	$ 0.70	$ 0.36
Net income per common share, diluted	$ 0.67	$ 0.35

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of the beginning of fiscal 2004, nor are they necessarily indicative of the results that will be obtained in the future.

FS Forth-Systeme GmbH/Sistemas Embebidos S.A.

Effective April 1, 2005, the Company acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (collectively referred to as FS Forth) from Embedded Solutions AG of Germany. FS Forth is a provider of embedded modules, software and development services. The purchase price included a payment of $4.8 million in cash, with contingent consideration of up to $2.0 million payable in installments of $0.8 million on October 1, 2006 and $1.2 million on October 1, 2007 if FS Forth achieves certain future milestones.

The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in goodwill of $2.4 million. The Company believes that the FS Forth acquisition resulted in the recognition of goodwill primarily because of the anticipated extension of its commercial device networking module business. FS Forth currently has modules that will immediately add value to the Company’s broader module product line. The Company has determined that FS Forth’s line of embedded modules, software and development services are part of the Device Networking Solutions segment.

FS Forth’s operating results are included in the Company’s consolidated results of operations from the date of acquisition. The consolidated balance sheet as of September 30, 2005 reflects the allocation of the purchase

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. ACQUISITIONS (CONTINUED)

price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The table below sets forth the purchase price allocation (in thousands):

Cash	$ 4,613
Direct acquisition costs	141
	$ 4,754
Fair value of net tangible assets acquired	$ 1,154
Identifiable intangible assets:	
Purchased and core technology	720
Customer relationships	1,290
Goodwill	2,374
Deferred tax liabilities related to identifiable intangibles	(784)
	$ 4,754

The purchased and core technology and customer relationships identified above have useful lives of three years. Useful lives for identifiable intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects 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 asset is consumed.

The Company has determined that the FS Forth acquisition was not material to the consolidated results of operations or financial condition of the Company; therefore, pro forma financial information is not presented.

In June 2001, the Company acquired INXTECH, a French designer and manufacturer of data communications systems sold under the Xcell Technology brand. In October 2000, the Company acquired Inside Out Networks, a developer of data connections products based in Austin, Texas. Both of these acquisitions included contingent purchase price payments based upon the achievement of certain pre-established operational targets. During fiscal 2004, the Company paid an aggregate of $2.0 million of additional cash consideration related to the Inside Out Networks acquisition. During fiscal 2003, the Company paid $2.0 of additional cash consideration related to the INXTECH and Inside Out Networks acquisitions. The additional consideration was accounted for as an addition to goodwill at the time the specified revenues and operating income targets were achieved. There are no outstanding contingent purchase price obligations related to these two acquisitions as of September 30, 2005.

3. GAIN FROM FORGIVENESS OF GRANT PAYABLE

During 2003, the Company recognized a $0.6 million gain as a component of operating income because the Company fulfilled the terms of an investment grant made by the German government which required it to occupy its building in Dortmund, Germany through August 2003.

4. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS — CHANGE IN ACCOUNTING PRINCIPLE

The Company adopted the provisions of FAS 142 as of October 1, 2002. FAS 142 provided that goodwill and other intangible assets with indefinite lives are no longer amortized, but rather are reviewed for impairment at least annually and more frequently in certain circumstances using a two-step process. The first step is to identify a potential impairment and, in transition, this step must be measured as of the beginning of the fiscal year. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of adoption), if any, and must be completed by the end of the Company's fiscal year.

In connection with the adoption of FAS 142, management determined the fair value of each of the Company's three reporting units as of October 1, 2002 as part of the Company's adoption of FAS 142 effective that date. Based on this valuation, which utilized a discounted cash flow valuation technique and considered fair values indicated by both the income approach and the market approach, the Company concluded that an impairment was indicated. Accordingly, the Company measured the fair values of the individual assets and liabilities of each reporting unit and determined that there was a total goodwill impairment charge of $43.9 million which the Company recorded in the first quarter of fiscal 2003. The impairment was attributable to the carrying value of goodwill related to three acquisitions, primarily that of NetSilicon. The impairment resulted from significant changes in the Company's expected future cash flows that resulted from a decline in anticipated future revenues due both to the general downturn in the worldwide economy and to a severe downturn in the networking communications and semiconductor industries. As a result of the downturn in expected future revenues and a substantial decline in the Company's market capitalization during fiscal 2002, the indicated fair values of the Company's reporting units had declined substantially since the acquisitions. The charge was reported as a cumulative effect of a change in accounting principle. There was no income tax effect associated with this impairment charge.

Amortized identifiable intangible assets as of September 30, 2005 and 2004, by reportable business segment, are comprised of the following (in thousands):

	As of September 30, 2005						
	Connectivity Solutions Segment		Device Networking Solutions Segment		Total		
	Gross carrying amount	Accum. amort.	Gross carrying amount	Accum. amort.	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$20,614	$(19,247)	$20,472	$ (7,270)	$41,086	$(26,517)	$14,569
License agreements	40	(40)	2,400	(1,450)	2,440	(1,490)	950
Patents and trademarks	1,600	(1,044)	4,091	(912)	5,691	(1,956)	3,735
Customer maintenance contracts	—	—	700	(254)	700	(254)	446
Customer relationships	—	—	7,803	(1,161)	7,803	(1,161)	6,642
Total	$22,254	$(20,331)	$35,466	$(11,047)	$57,720	$(31,378)	$26,342

4. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS – CHANGE IN ACCOUNTING PRINCIPLE (CONTINUED)

	As of September 30, 2004						
	Connectivity Solutions Segment		Device Networking Solutions Segment		Total		
	Gross carrying amount	Accum. amort.	Gross carrying amount	Accum. amort.	Gross carrying amount	Accum. amort.	Net
Purchased and core technology	$20,614	$(17,304)	$11,100	$(4,856)	$31,714	$(22,160)	$ 9,554
License agreements	40	(32)	2,400	(1,050)	2,440	(1,082)	1,358
Patents and trademarks	1,312	(759)	1,406	(592)	2,718	(1,351)	1,367
Customer maintenance contracts	—	—	700	(184)	700	(184)	516
Customer relationships	—	—	2,200	(578)	2,200	(578)	1,622
Total	$21,966	$(18,095)	$17,806	$(7,260)	$39,772	$(25,355)	$14,417

Amortization expense for fiscal years 2005, 2004 and 2003, by reportable business segment, is as follows (in thousands):

Fiscal year	Connectivity Solutions Segment	Device Networking Solutions Segment	Total
2005	$2,245	$3,792	$6,037
2004	$2,844	$2,773	$5,617
2003	$3,933	$2,764	$6,697

Estimated amortization expense for the next five years is as follows (in thousands):

2006	$7,227
2007	5,859
2008	3,997
2009	2,765
2010	2,608

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. GOODWILL AND OTHER IDENTIFIABLE INTANGIBLE ASSETS – CHANGE IN ACCOUNTING PRINCIPLE (CONTINUED)

The changes in the carrying amount of goodwill for fiscal 2005 and 2004 are as follows (in thousands):

	Fiscal 2005			Fiscal 2004		
	Connectivity Solutions Segment	Device Networking Solutions Segment	Total	Connectivity Solutions Segment	Device Networking Solutions Segment	Total
Beginning balance, October 1	$5,265	$ 551	$ 5,816	$3,304	$551	$3,855
Acquisition of Rabbit	—	30,644	30,644	—	—	—
Acquisition of FS Forth	—	2,374	2,374	—	—	—
Other, primarily contingent purchase price payments and currency translation adjustment	—	(159)	(159)	1,961	—	1,961
Ending balance, September 30	$5,265	$33,410	$38,675	$5,265	$551	$5,816

5. RESTRUCTURING

In fiscal 2003, the Company recorded a $0.6 million decrease in operating expenses due to a change in estimated severance payments accrued in connection with fiscal 2002 restructuring activities. The change in estimate resulted primarily from favorable settlements in 2003 of previously agreed upon severance amounts including related legal fees. The restructuring was completed in the second quarter of fiscal 2004 as certain automobile and building lease payments were scheduled to be paid through that date. Cash outlays were funded by cash generated from the Company’s operations. The Company’s restructuring activities are summarized as follows (in thousands):

Description	Balance at Sept. 30, 2002	Payments	Change in Estimate	Balance at Sept. 30, 2003	Payments	Balance at Sept. 30, 2004
Digi Restructuring Plan:						
- Severance and termination costs	$1,386	$(1,042)	$(344)	$—	$ —	$—
- Building closing/lease cancellation fees	72	(56)	(16)	—	—	—
- Cancellation fees for automobile leases	29	(17)	(3)	9	(9)	—
- Legal and professional fees	159	(54)	(100)	5	(5)	—
Subtotal	1,646	(1,169)	(463)	14	(14)	—
NetSilicon Restructuring Plan:						
- Severance and termination costs	661	(641)	(20)	—	—	—
- Building closing/lease cancellation fees	161	(41)	(117)	3	(3)	—
- Cancellation fees for automobile leases	36	(36)	—	—	—	—
Subtotal	858	(718)	(137)	3	(3)	—
Totals	$2,504	$(1,887)	$(600)	$17	$(17)	$—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. SEGMENT INFORMATION AND MAJOR CUSTOMERS

The Company operates in two reportable segments, the Connectivity Solutions Segment and the Device Networking Solutions Segment.

Connectivity Solutions — Connectivity Solutions are used by businesses to create, customize, and control retail operations, industrial automation, and other applications. The primary product lines include terminal servers, USB connectivity, multi-port serial adaptors, Integrated Services Digital Network (ISDN), and Remote Access Server (RAS). In February 2005, the Company announced the introduction of the Wireless/Cellular product line which is also included in the Connectivity Solutions segment. Product introductions within this product line provide serial-to-wireless and Ethernet-to-wireless IP connectivity to remote sites and devices via the cellular GSM network. This reporting segment is comprised of two operating units. The operating units include the USB products associated with the
Company's Inside Out Networks subsidiary, and the products associated with all other operations of the Company, excluding NetSilicon and the Device Server product line.

Device Networking Solutions – Device Networking Solutions are integrated hardware and software solutions for manufacturers and integrators who want to build network-ready products and solutions. This family of solutions integrates network-enabled microprocessors (specialized computer chips), an operating system, networking software, development tools, and a high level of technical support. The primary product lines include device servers, integrated microprocessors, integrated microprocessor-based modules, printer controller boards, and network interface cards. In addition, the Company licenses software products that are embedded into electronic devices to enable Internet and Web-based communications. The operations of Rabbit, FS Forth and NetSilicon branded products and the Device Server product line comprise this segment.

Summary fiscal year financial data by business segment are presented below (in thousands):

	2005			2004			2003		
	Connectivity Solutions	Device Networking Solutions	Total	Connectivity Solutions	Device Networking Solutions	Total	Connectivity Solutions	Device Networking Solutions	Total
Net sales	$75,527	$49,671	$125,198	$ 73,564	$ 37,662	$111,226	$ 72,087	$ 30,839	$102,926
Operating income (loss)	21,461	(4,504)	16,957	22,707	(10,926)	11,781	19,070	(12,797)	6,273
Total assets	97,825	79,806	177,631	133,136	17,329	150,465	111,148	21,392	132,540
Depreciation expense	1,538	757	2,295	2,161	271	2,432	2,271	860	3,131
Capital expenditures	1,065	264	1,329	1,215	78	1,293	1,631	60	1,691

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. SEGMENT INFORMATION AND MAJOR CUSTOMERS (CONTINUED)

The Company considers operating income (loss) to be the primary measure by which it measures the operating performance of each segment. A reconciliation of the Company's consolidated segment operating income (loss) to consolidated income before income taxes and cumulative effect of accounting change follows (in thousands):

	Year Ended September 30,		
	2005	2004	2003
Operating income — Connectivity Solutions	$ 21,461	$ 22,707	$ 19,070
Operating loss — Device Networking Solutions	(4,504)	(10,926)	(12,797)
	16,957	11,781	6,273
Other income, net	1,026	369	296
Consolidated income before income taxes and cumulative effect of accounting change	$ 17,983	$ 12,150	$ 6,569

The information in the following table is based upon the geographic location of the customer for the years ended September 30, 2005, 2004 and 2003 (in thousands):

Revenue derived by geographic location:

	Year Ended September 30,		
	2005	2004	2003
United States	$ 72,004	$ 61,881	$ 66,410
Europe	29,380	23,090	22,842
Asia Pacific	22,167	25,717	13,206
Other international	1,647	538	468
	$ 125,198	$ 111,226	$ 102,926

Net long-lived assets by geographic location:

	As of September 30,		
	2005	2004	2003
United States	$ 76,663	$ 32,715	$ 36,014
International, primarily Europe	9,162	6,152	7,477
	$ 85,825	$ 38,867	$ 43,491

The Company's U.S. export sales comprised 42.5%, 44.2% and 35.5% of net sales for the years ended September 30, 2005, 2004 and 2003, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. SEGMENT INFORMATION AND MAJOR CUSTOMERS (CONTINUED)

The following table identifies customers whose net sales comprised more than 10% of net sales during the years ended September 30, 2005, 2004 and 2003 as well as customers who comprised more than 10% of trade accounts receivable as of September 30, 2005, 2004 and 2003:

	Year Ended September 30,					
	2005		2004		2003	
	Net Sales %	Accts. Rec. %	Net Sales %	Accts. Rec. %	Net Sales %	Accts. Rec. %
Customer A	*	10.3%	*	24.7%	11.3%	21.8%
Customer B	12.9%	*	15.6%	*	15.2%	12.2%
Customer C	*	*	*	11.6%	*	*
Customer D	*	*	*	10.3%	*	*

* Represents less than 10% of net sales or trade accounts receivable, as applicable

7. SELECTED BALANCE SHEET DATA

As of September 30, (in thousands)	2005	2004
Accounts receivable, net:		
Accounts receivable	$ 17,769	$ 11,577
Less allowance for doubtful accounts	872	1,022
	$ 16,897	$ 10,555
Inventories, net:		
Raw materials	$ 15,074	$ 8,767
Work in process	569	96
Finished goods	2,884	2,368
	$ 18,527	$ 11,231
Property, equipment and improvements, net:		
Land	$ 2,351	$ 2,364
Buildings	20,124	20,350
Improvements	2,638	1,960
Equipment	17,484	17,418
Purchased software	9,794	10,237
Furniture and fixtures	1,615	1,320
	54,006	53,649
Less accumulated depreciation and amortization	33,198	35,015
	$ 20,808	$ 18,634

Included in equipment at September 30, 2005 is $1.9 million of equipment under capital lease with accumulated depreciation of $0.2 million.

8. FINANCIAL GUARANTEES

The Company, in general, warrants its products to be free from defects in material and workmanship under normal use and service. The warranty periods range from 90 days to five years from the date of receipt. Rabbit products, in general, are warranted for a period of 90 days. The Company has the option to repair or replace products it deems defective due to material or workmanship. Estimated warranty costs are accrued in the period that the related revenue is recognized based upon an estimated average per unit repair or replacement cost

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. FINANCIAL GUARANTEES (CONTINUED)

applied to the estimated number of units under warranty. These estimates are based upon historical warranty incidents and are evaluated on an ongoing basis to ensure the adequacy of the warranty accrual. The following table summarizes the activity associated with the product warranty accrual for the years ended September 30, 2005, 2004 and 2003 (in thousands):

Fiscal year	Balance at October 1,	Accruals for Warranties issued	Settlements made	Balance at September 30,
2005	$855	$900(1)	$(568)	$1,187
2004	$879	$493	$(517)	$ 855
2003	$895	$461	$(477)	$ 879

(1) Includes $97 of warranty liabilities assumed as a result of acquisitions described in Note 2.

The Company is not responsible and does not warrant that customer software versions created by OEM customers based upon the Company's software source code will function in a particular way, conform to any specifications, are fit for any particular purpose and does not indemnify these customers from any third party liability as it relates to or arises from any customization or modifications made by the OEM customer.

9. CAPITAL LEASE OBLIGATIONS AND SHORT-TERM BORROWINGS

On May 20, 2005, the Company entered into a short-term note with Wells Fargo in the amount of $21.0 million. This short-term note was used to finance the Rabbit acquisition. Per the terms of the agreement, payment of the outstanding balance was due October 1, 2005; however, the Company had the option to prepay without penalty. The Company paid the note in full on July 15, 2005. Interest was based on the daily LIBOR rate plus 0.35% which ranged between 3.39% and 3.68% from the date of the loan through July 15, 2005.

At the time the Company acquired Rabbit (see Note 2), Rabbit maintained a $5.0 million revolving line of credit with an outstanding balance of $1.3 million. The Company repaid all but $1,000 of this line of credit which is classified as a current short-term borrowing. Borrowings available under the line are based on an asset-based borrowing calculation. On September 30, 2005 the total amount available for disbursement was $4.999 million. Interest is accrued based on one of two options: the one-year LIBOR rate plus 2% or the bank's prime lending rate. The interest rate as of September 30, 2005 was 7.88%. The line expires January 31, 2006 unless renewed.

During fiscal 2003, the Company entered into a short-term borrowing agreement with Sparkasse Dortmund in the amount of 1.7 million Euros ($2.0 million) at September 30, 2003 at a fixed interest rate of 3.64%. The Company paid off this borrowing on its due date in January 2004.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. CAPITAL LEASE OBLIGATIONS AND SHORT-TERM BORROWINGS (CONTINUED)

At the time the Company acquired Rabbit and FS Forth (see Note 2), Rabbit and FS Forth had outstanding capital lease agreements for equipment. The following table summarizes future amounts due under capital leases (in thousands):

Fiscal Year	
2006	$ 507
2007	473
2008	420
2009	307
2010	80
Total minimum payments required	1,787
Less interest on capital lease obligations	(193)
Net minimum principal payments	1,594
Less capital lease obligations, current portion	(413)
Capital leases obligations, net of current portion	$ 1,181

10. INCOME TAXES

The components of the provision (benefit) for income taxes before cumulative effect of accounting change is as follows (in thousands):

	For the years ended September 30,		
	2005	2004	2003
Currently payable:			
Federal	$ (2,325)	$ 923	$ 1,544
State	968	700	439
Foreign	623	416	592
Deferred:			
U.S.	589	1,266	(548)
Foreign	463	182	(2,050)
	$ 318	$ 3,487	$ (23)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. INCOME TAXES (CONTINUED)

The net deferred tax asset at September 30 consists of the following (in thousands):

	2005	2004
Current deferred tax asset	$ 2,892	$ 2,794
Non-current deferred tax asset	—	3,013
Non-current deferred tax liability	(2,195)	(208)
Net deferred tax asset	$ 697	$ 5,599

	2005	2004
Uncollectible accounts and other reserves	$ 1,765	$ 1,562
Inventories	984	781
Compensation costs	515	451
Net operating loss carryforwards	3,137	5,656
Tax credit carryforwards	4,246	2,408
Identifiable intangible assets	(9,950)	(5,259)
Net deferred tax asset	$ 697	$ 5,599

As of September 30, 2005, the Company had domestic federal net operating loss carryforwards and tax credit carryforwards of approximately $8.5 million and $4.1 million, respectively, which expire at various dates through 2024. All of the $8.5 million of net operating loss carryforwards and approximately $0.8 million of tax credit carryforwards relate to an acquisition and are subject to annual use limitations of $2.8 million, in accordance with provisions of the Internal Revenue Code.

The Company has concluded that it is more likely than not that net deferred tax assets will be realized based on future projected taxable income and the anticipated future reversal of deferred tax liabilities, and therefore no valuation allowance has been established at September 30, 2005. The amount of the net deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the amounts of future taxable income. If the Company's future taxable income projections are not realized, a valuation allowance would be required, and would be reflected as income tax expense at the time that any such change in future taxable income is determined.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. INCOME TAXES (CONTINUED)

The reconciliation of the statutory federal income tax rate to the Company's effective income tax rate before cumulative effect of an accounting change for the years ended September 30 is as follows:

	2005	2004	2003
Statutory income tax rate	35.0%	35.0%	34.0%
Increase (decrease) resulting from:			
State taxes, net of federal benefits	3.5	3.8	4.4
Utilization of tax credits	(3.4)	(4.8)	(3.4)
Extraterritorial income tax benefit	(3.0)	(3.6)	(2.9)
Non-deductible Rabbit acquisition costs	0.6	—	—
Reversal of tax reserves due to settlement of audit	(31.6)	—	—
Additional NOLs on NetSilicon acquisition	—	—	(6.6)
Reversal of valuation allowance	—	—	(21.5)
Other	0.7	(1.7)	(4.3)
	1.8%	28.7%	(0.3%)

In the first quarter of fiscal 2005, the Internal Revenue Service (IRS) completed an audit of certain of the Company's prior fiscal years income tax returns, subject to final approval by the Congressional Joint Committee on Taxation. As a result of a settlement agreement associated with this audit, the Company paid $3.2 million to the IRS in the first quarter of fiscal 2005 resulting in a reduction to the income taxes payable liability. In February 2005, the Congressional Joint Committee on Taxation approved the settlement with the IRS. The Company had tax reserves recorded in excess of the ultimate amount settled, resulting in an income tax benefit of $5.7 million in fiscal 2005 representing the excess income tax reserves over the amount paid.

In March 2003, the Company reversed the valuation allowance associated with its German net operating loss carryforwards. The valuation allowance was reversed based upon current and anticipated future taxable income generated by the Company's German operations. The portion of the valuation allowance related to the German net operating loss carryforwards that was expected to be utilized by the Company during the year ended September 30, 2003 was accounted for by reducing the effective income tax rate for the current year. The portion of the valuation allowance related to the German net operating loss carryforwards that was expected to be utilized by the Company during periods subsequent to September 30, 2003 was accounted for as a discrete event and resulted in an income tax benefit of $1.4 million being recorded during fiscal 2003 as part of deferred tax expense.

11. STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN

The Company's Stock Option Plan (the Stock Option Plan) provides for the issuance of nonstatutory stock options (NSOs) and incentive stock options (ISOs) to key employees and nonemployee board members holding not more than 5% of the outstanding shares of the Company's common stock. The Company's Non-Officer Stock Option Plan (the Non-Officer Plan) provides for the issuance of NSOs to key employees who are not officers or directors of the Company. The Company's 2000 Omnibus Stock Plan (the Omnibus Plan) and, together with the Stock Option Plan and the Non-Officer Plan (the Plans), provides for the issuance of stock-based incentives, including ISOs and NSOs, to employees and others who provide services to the Company, including consultants, advisers and directors. Options granted under the Plans will expire if unexercised after ten years from the date of grant. Options granted under the Plans generally vest over a four year service period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN (CONTINUED)

The exercise price for ISOs and non-employee director options granted under the Stock Option Plan or the Omnibus Plan is set at the fair market value of the Company's common stock based on the closing price on the date of grant. The exercise price for nonstatutory options granted under the Plans is set by the Compensation Committee of the Board of Directors. The authority to grant options under the Plans and set other terms and conditions rests with the Compensation Committee. The Stock Option Plan and Non-Officer Plan terminate in 2006 and the Omnibus Plan terminates in 2010.

The Plans have provisions allowing employees to elect to pay their withholding obligation through share reduction. No employees elected to pay income tax withholding obligations through share reduction during fiscal 2005, 2004 or 2003.

In connection with the acquisition of NetSilicon in fiscal 2002, the Company assumed options to purchase shares of common stock of NetSilicon under the NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan, the NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan and the NetSilicon, Inc. 2001 Stock Option and Incentive Plan (the Assumed Plans), which options became exercisable for shares of the Company's common stock. The Company cannot grant additional awards under these plans.

Stock options and common shares reserved for grant under the Plans and Assumed Plans are as follows (in thousands, except per common share amounts):

	Available For Grant	Options Outstanding	Weighted Average Price per Common Share
Balances, September 30, 2002	2,069	6,152	$ 9.17
Granted	(818)	818	3.46
Exercised	—	(58)	5.27
Cancelled	751	(1,056)	9.02
Balances, September 30, 2003	2,002	5,856	$ 8.44
Granted	(640)	640	10.02
Exercised	—	(1,466)	5.86
Cancelled	126	(245)	14.28
Balances, September 30, 2004	1,488	4,785	$ 9.15
Granted	(635)	635	13.41
Exercised	—	(778)	7.20
Cancelled	97	(131)	12.91
Balances, September 30, 2005	950	4,511	$ 9.98
Exercisable at September 30, 2003		4,385	$ 9.47
Exercisable at September 30, 2004		3,869	$ 9.33
Exercisable at September 30, 2005		3,544	$ 9.54

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN (CONTINUED)

At September 30, 2005, the weighted average exercise price and remaining life of the stock options are as follows (in thousands, except remaining life and exercise price):

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Less than $5.00	290	7.2	$ 2.75	240	$ 2.71
$5.00 — $5.99	561	6.0	$ 5.38	514	$ 5.37
$6.00 — $6.99	225	5.5	$ 6.52	198	$ 6.49
$7.00 — $7.99	485	5.2	$ 7.26	465	$ 7.27
$8.00 — $8.99	92	3.2	$ 8.36	80	$ 8.31
$9.00 - $9.99	372	7.6	$ 9.62	352	$ 9.60
$10.00 — $10.99	1,470	5.4	$ 10.70	1,141	$ 10.73
$11.00 — $12.99	267	4.0	$ 12.00	222	$ 12.00
$13.00 - $19.99	559	7.8	$ 14.52	142	$ 13.94
$20.00 — $27.69	190	3.3	$ 25.33	190	$ 25.33
$2.19 - $27.69	4,511			3,544	

The Company sponsored Employee Stock Purchase Plan (the Purchase Plan) covers all domestic employees with at least 90 days of service. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Employee contributions to the Purchase Plan were $0.5 million, $0.7 million and $0.6 million in the fiscal years ended 2005, 2004 and 2003, respectively. Pursuant to the Purchase Plan, 71,345, 103,875 and 281,111 common shares were issued to employees during the fiscal years ended 2005, 2004 and 2003, respectively. As of September 30, 2005, 252,150 common shares are available for future issuances under the Purchase Plan.

12. SHARE RIGHTS PLAN

The Company has adopted a share rights plan. Each right entitles its holder to buy one one-hundredth of a share of a new series of junior participating preferred stock at an exercise price of $115, subject to adjustment. The rights are exercisable only if certain ownership considerations are met. The Company will be entitled to redeem the rights prior to the rights becoming exercisable.

13. COMMITMENTS

The Company has entered into various operating lease agreements for office facilities and equipment, the last of which expires in fiscal 2013. The office facility leases generally require the Company to pay a pro-rata share of the lessor’s operating expenses. The following schedule reflects future minimum rental commitments under noncancelable operating leases. These minimum payments have not been reduced by minimum sublease rentals of $0.2 million due in the future under noncancelable subleases.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

13. COMMITMENTS (CONTINUED)

Fiscal Year	Amount (in thousands)
2006	$ 1,879
2007	1,626
2008	813
2009	435
2010	421
Thereafter	987
Total minimum payments required	$ 6,161

The following schedule shows the composition of total rental expense for all operating leases for the years ended September 30, (in thousands):

	2005	2004	2003
Rentals	$ 1,921	$ 1,652	$ 1,562
Less: sublease rentals	(183)	(129)	(109)
	$ 1,738	$ 1,523	$ 1,453

14. EMPLOYEE BENEFIT PLANS

The Company currently has a savings and profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code (the Code), whereby eligible employees may contribute pre-tax earnings, not to exceed amounts allowed under the Code.

Employees may contribute up to 25% of their pre-tax earnings (not to exceed amounts allowed under the Code). The Company provides a match of 100% on the first 3% of each employee’s bi-weekly contribution and a 50% match on the next 2% of each employee’s bi-weekly contribution. In addition, the Company may make contributions to the plan at the discretion of the Board of Directors. The Company provided matching contributions of $0.8 million, $0.8 million and $0.5 million in the fiscal years ended September 30, 2005, 2004 and 2003, respectively.

15. CONTINGENCIES

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of NetSilicon and approximately 300 other public companies. The complaint names as defendants the Company, NetSilicon, certain of its officers and certain underwriters involved in NetSilicon’s IPO, among numerous others, and asserts, among other things, that NetSilicon’s IPO prospectus and registration statement violated federal securities laws because they contained material misrepresentations and/or omissions regarding the conduct of NetSilicon’s IPO underwriters in allocating shares in NetSilicon’s IPO to the underwriters’ customers. The Company believes that the claims against the NetSilicon defendants are without merit and has defended the litigation vigorously. Pursuant to a stipulation between the parties, the two named officers were dismissed from the lawsuit, without prejudice, on October 9, 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

15. CONTINGENCIES (CONTINUED)

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

Consummation of the proposed settlement remains conditioned upon obtaining approval by the Court. On September 1, 2005, the Court preliminarily approved the proposed settlement, directed that notice of the terms of the proposed settlement be provided to class members, and scheduled a fairness hearing, at which objections to the proposed settlement will be heard. Thereafter the Court will determine whether to grant final approval to the proposed settlement.

If the proposed settlement is not consummated, the Company intends to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, and there can be no guarantee as to the ultimate outcome of this pending lawsuit. The Company maintains liability insurance for such matters and expects that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of $250,000 per claim. As of September 30, 2005, the Company has accrued a liability for the deductible amount of $250,000 which the Company believes reflects the amount of loss that is probable. In the event the Company has losses that exceed the limits of the liability insurance, such losses could have a material effect on the business, or consolidated results of operations or financial condition of the Company.

On April 13, 2004, the Company filed a lawsuit against Lantronix Inc. (Lantronix) alleging that certain of Lantronix's products infringe the Company's U.S. Patent No. 6,446,192. The Company filed the lawsuit in the U.S. District Court in Minnesota. The lawsuit seeks both monetary and non-monetary relief. On May 3, 2004, Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,571,305, in the U.S. District Court for the Central District of California. The lawsuit seeks both monetary and non-monetary relief. On February 7, 2005 Lantronix and Acticon Technologies LLC filed a lawsuit against the Company alleging that certain of the Company's products infringe U.S. Patent No. 4,972,470. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit seeks both monetary and non-monetary relief. On May 12, 2005 Lantronix filed a lawsuit against the Company alleging that certain of the Company's products infringe Lantronix's U.S. Patent No. 6,881,096. The lawsuit was filed in the U.S. District Court for the Eastern District of Texas. The lawsuit seeks both monetary and non-monetary relief. The Company believes the impact of these disputes on the business, or consolidated results of operations or financial condition of the Company, will not be material.

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

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SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Description	Balance at beginning of period	Charged to costs and expenses	Deductions	Balance at end of period
Valuation account — doubtful accounts				
September 30, 2005	$ 1,022	$ (123)	$ 27(1)	$ 872
September 30, 2004	1,017	18	13(1)	1,022
September 30, 2003	1,278	(30)	231(1)	1,017

(1) Uncollectible accounts charged against allowance, net of recoveries

QUARTERLY FINANCIAL DATA (UNAUDITED)
(in thousands, except per common share data)

Quarterly Financial Data (unaudited):

	Quarter ended			
	Dec. 31	Mar. 31	June 30	Sept. 30
2005				
Net sales	$ 29,470	$ 29,312	$ 30,208	$ 36,208
Gross profit	18,311	17,984	18,205	21,182
Net income	2,961	8,799	2,484	3,421
Net income per common share — basic	0.13	0.39	0.11	0.15
Net income per common share — diluted	0.13	0.37	0.11	0.15
2004				
Net sales	$ 26,307	$ 27,339	$ 28,306	$ 29,274
Gross profit	16,104	16,534	17,261	17,884
Net income	1,647	1,737	2,394	2,885
Net income per common share — basic	0.08	0.08	0.11	0.13
Net income per common share — diluted	0.08	0.08	0.11	0.13
2003				
Net sales	$ 25,528	$ 25,511	$ 25,567	$ 26,320
Gross profit	15,347	15,194	15,251	15,554
Income before income taxes and cumulative effect of accounting change	1,466	1,413	1,740	1,950
Cumulative effect of accounting change (net of income tax benefit of $0)	(43,866)	—	—	—
Net (loss) income	(42,796)	2,504	1,213	1,805
Net income per common share, before cumulative effect of accounting change — basic	0.05	0.12	0.06	0.09
— diluted	0.05	0.12	0.06	0.09
Net loss per common share from cumulative effect of accounting change — basic	(1.99)	—	—	—
— diluted	(1.99)	—	—	—
Net (loss) income per common share — basic	(1.94)	0.12	0.06	0.09
Net (loss) income per common share — diluted	(1.94)	0.12	0.06	0.09

The summation of quarterly net income per common share may not equate to the year-end calculation as quarterly calculations are performed on a discrete basis.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed 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.

Management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2005 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of September 30, 2005. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of September 30, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

On April 1, 2005, the Company acquired FS Forth-Systeme GmbH/Sistemas Embebidos S.A. (FS Forth) and on May 26, 2005, the Company acquired Rabbit Semiconductor Inc. (Rabbit). FS Forth and Rabbit, whose total assets represented 3.1% and 34.2%, respectively, of total consolidated assets as of September 30, 2005 and whose total net sales represented 2.1% and 8.5%, respectively, of total consolidated net sales for the year ended September 30, 2005, were acquired in purchase business combinations and were excluded from the Company's September 30, 2005 assessment of the effectiveness of the Company's internal control over financial reporting.

Changes in Internal Control Over Financial Reporting

Other than the changes resulting from the FS Forth and Rabbit acquisitions, there have been no significant changes in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

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PART III

ITEM 10. EXECUTIVE OFFICERS OF THE REGISTRANT

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

Name	Age	Position
Joseph T. Dunsmore	47	Chairman, President and Chief Executive Officer
Subramanian Krishnan	51	Senior Vice President, Chief Financial Officer and Treasurer
Lawrence A. Kraft	39	Senior Vice President of Sales and Marketing
Joel K. Young	40	Vice President of Research and Development, and Chief Technical Officer

Mr. Dunsmore joined the Company in October 1999 as President and Chief Executive Officer and a member of the Board of Directors and was elected Chairman of the Board in May 2000. Prior to joining the Company, Mr. Dunsmore was Vice President of Access for Lucent Microelectronics, a telecommunications company now known as Agere Systems Inc., since June 1999. From October 1998 to June 1999, he acted as an independent consultant to various high technology companies. From February 1998 to October 1998, Mr. Dunsmore was Chief Executive Officer of NetFax, Inc., a telecommunications company. From October 1995 to February 1998, he held executive management positions at US Robotics and then at 3COM after 3COM acquired US Robotics in June 1997. Prior to that, Mr. Dunsmore held various marketing management positions at AT&T Paradyne Corporation from May 1983 to October 1995.

Mr. Krishnan was named Senior Vice President, Chief Financial Officer and Treasurer on February 1, 1999, prior to which he served as the Company's Vice President of Finance since January 11, 1999. Prior to joining the Company, he served as a principal with LAWCO Financial, an investment banking firm in Minneapolis, Minnesota from January 1997 to January 1999. Prior to LAWCO, he served for 13 years with the Valspar Corporation as the Director of Corporate Financial Planning and Reporting and Taxes and was primarily responsible for mergers, acquisitions and joint ventures.

Mr. Kraft joined the Company as Vice President of Americas Sales and Marketing in February 2003 and was named Senior Vice President of Sales and Marketing in November 2005. Prior to joining the Company, Mr. Kraft was Vice President of Marketing for Advanced Switching Communications (ASC), a provider of broadband access platforms, from June 1999 to February 2002 where he built a marketing and product management organization. From July 1998 to October 1998, Mr. Kraft was Vice President of Marketing for NetFax, Inc., a telecommunications company. Mr. Kraft also previously held the positions of Manager of Product Marketing at 3COM/U.S. Robotics, Vice President of Marketing for ISDN Systems Corporation, and Group Products Manager for the Internet access program at Sprint Corporation.

Mr. Young joined the Company in July 2000 as Vice President of Engineering and was named Vice President of Research and Development and Chief Technical Officer in November 2005. Prior to joining the Company, Mr. Young served as a Vice President for Transcrypt International, a provider of encryption products, in various engineering, sales and marketing positions from February 1996 to June 2000. Before that, he held various engineering and management positions at AT&T and AT&T Bell Laboratories from 1986 to 1996. When he left AT&T, he was a District Manager responsible for creating new business services.

CODE OF ETHICS

The Company adopted a "code of ethics" within the meaning of Rule 406 of Regulation S-K, which is applicable to the Company's senior financial management, including specifically the Company's Chief Executive Officer, Chief Financial Officer and Controller. A copy of this code of ethics is listed as an exhibit to this report. The Company intends to satisfy its disclosure obligations regarding any amendment to, or a waiver from, a provision of this code of ethics by posting such information on the Company's website at www.digi.com. The Company also has a "code of conduct" that applies to all directors, officers and employees, a copy of which is available through the Company's website (www.digi.com) under the "About us – Investor Relations – Corporate Governance" caption.

ITEM 12. EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of September 30, 2005 for compensation plans under which equity securities may be issued.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity Compensation Plans Approved by Security Holders	1,922,149	$ 10.22	1,029,036 (1)
Equity Compensation Plans Not Approved by Security Holders (2)	1,335,663	$ 8.12	173,153
Total (3)	3,257,812	$ 9.36	1,202,189

(1) Includes securities available for future issuance under stockholder approved compensation plans other than upon the exercise of an option, warrant or right, as follows: 26,886 shares under the Company's Stock Option Plan, 750,000 shares under the Company's 2000 Omnibus Stock Plan and 252,150 shares under the Company's Employee Stock Purchase Plan.

(2) Relates to the Digi International Inc. Non-Officer Stock Option Plan only.

(3) The table does not include information for equity compensation plans assumed by the Company pursuant to the acquisition of NetSilicon, Inc. by the Company in February 2002. Pursuant to the Agreement and Plan of Merger, the Company assumed options to purchase 4,134,658 shares of common stock of NetSilicon granted under three different plans, which became exercisable for an aggregate of 2,687,528 shares of common stock of the Company. All of the options assumed by the Company remain subject to the assumed plans until the options are exercised or expire. As of September 30, 2005, 1,252,951 options remained outstanding at a weighted average exercise price of $11.54. The Company cannot grant additional awards under these assumed plans.

ITEM 12. EQUITY COMPENSATION PLAN INFORMATION (CONTINUED)

EQUITY COMPENSATION PLANS NOT APPROVED BY SECURITY HOLDERS

Digi International Inc. Non-Officer Stock Option Plan

In April 1998, the Board adopted the Digi International Inc. Non-Officer Stock Option Plan (the Non-Officer Plan). The Non-Officer Plan has not been approved by the stockholders of the Company.

Plan Administration. The Non-Officer Plan is administered by a committee of two or more members of the Board (the Committee). The Committee may delegate all or any part of its authority to a one person committee consisting of the Chief Executive Officer of the Company for purposes of granting awards.

Shares Subject to the Non-Officer Plan. As of September 30, 2005, 1,335,663 shares of the Company's common stock were subject to outstanding awards granted and 173,153 shares remained available for future award grants under the Non-Officer Plan. If any award granted pursuant to the Non-Officer Plan expires or terminates without being exercised in full, the unexercised shares released from such award will again become available for issuance under the Non-Officer Plan. The Committee, in its sole discretion, may adjust the number of shares and the purchase price per share to give effect to adjustments made in the number of outstanding common stock of the Company pursuant to mergers, consolidations, splits, combinations, or other changes in capitalization as described in the Non-Officer Plan.

Eligibility. All employees of the Company and its subsidiaries who are not also officers or directors of the Company, and consultants to the Company or its subsidiaries, are eligible to receive awards under the Non-Officer Plan.

Incentive and Non-Statutory Stock Options. The Non-Officer Plan authorizes the grant of non-statutory stock options. Because the Non-Officer Plan has not been approved by the Company's stockholders, under the Internal Revenue Code of 1986, as amended, incentive stock options may not be granted under the Non-Officer Plan. The exercise price of an option is determined by the Committee. The exercise price may not be less than 50% of the fair market value, as defined in the Non-Officer Plan, of the Company's common stock on the date the option is granted. Stock options may be granted and exercised at such times as the Committee may determine, provided that the term shall not exceed ten years from the date of grant. The purchase price for common stock purchased upon the exercise of stock options may be payable in cash, bank draft or money order, by delivery of shares of Company common stock having a fair market value on the date the option is exercised equal to all or any part of the option price of the common stock being purchased or any combination of the above.

Transferability and Termination of Options. The Non-Officer Plan allows the recipient to transfer options to members of his or her immediate family under certain circumstances. Other than such transfers to family members, no option shall be assignable or transferable by the recipient other than by will or the laws of descent and distribution. If a recipient's employment or other relationship with the Company or its affiliates is terminated for any reason other than death or disability, then any unexercised portion of such recipient's award will generally be forfeited, except as provided in the Non-Officer Plan or such recipient's agreement or by the Committee. Upon death or disability, any unexercised portion of such recipient's award will automatically vest. Upon a change in control as described in the Non-Officer Plan, the Committee shall declare all outstanding options cancelled at the time of the change in control in exchange for cash in the amount described in the Non-Officer Plan unless appropriate provisions have been made for the protection of the outstanding options by the substitution of such options for options to purchase appropriate stock of the surviving entity in the change in control.

ITEM 12. EQUITY COMPENSATION PLAN INFORMATION (CONTINUED)

EQUITY COMPENSATION PLANS NOT APPROVED BY SECURITY HOLDERS (CONTINUED)

Adjustments, Modifications, Termination. The Non-Officer Plan gives the Board the right to amend, suspend or discontinue the Non-Officer Plan. Amendments to the Non-Officer Plan are subject to stockholder approval, however, if needed to comply with applicable laws or regulations. The Committee may generally also alter or amend any agreement covering an award granted under the Non-Officer Plan to the extent permitted by law. The Committee may grant awards under the Non-Officer Plan until December 1, 2006.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Consolidated Financial Statements and Schedules of the Company

1. Consolidated Statements of Operations for the fiscal years ended September 30, 2005, 2004 and 2003

   Consolidated Balance Sheets as of September 30, 2005 and 2004

   Consolidated Statements of Cash Flows for the fiscal years ended September 30, 2005, 2004 and 2003

   Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the fiscal years ended September 30, 2005, 2004 and 2003

   Notes to Consolidated Financial Statements

2. Schedule of Valuation and Qualifying Accounts

3. Report of Independent Registered Public Accounting Firm

(b) Exhibits

Exhibit Number	Description
2(a)	Agreement and Plan of Merger among the Company, Dove Sub Inc. and NetSilicon, Inc. dated as of October 30, 2001 (1)
2(b)	Purchase and assignment contract dated March 20, 2005 between Embedded Solutions AG, Klaus Flesch, Angelika Flesch and Digi International GmbH (2)
2(c)	Agreement and Plan of Merger among Digi International Inc., Karat Sub Inc. and Z-World, Inc. dated as of May 26, 2005 (excluding schedules and exhibits, which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request) (3)
3(a)	Restated Certificate of Incorporation of the Company, as amended (4)
3(b)	Amended and Restated By-Laws of the Company, as amended (5)
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (6)
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (7)
10(a)	Stock Option Plan of the Company as Amended and Restated as of September 28, 2005*
10(b)	Form of indemnification agreement with directors and officers of the Company (8)

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (CONTINUED)

(b) Exhibits (continued)

Exhibit Number	Description
10(c)	Agreement between the Company and Subramanian Krishnan dated March 26, 1999* (9)
10(c)(i)	Amendment to Agreement between the Company and Subramanian Krishnan dated February 5, 2001* (10)
10(d)	Employment Agreement between the Company and Joseph T. Dunsmore dated October 24, 1999* (11)
10(e)	Agreement between the Company and Bruce Berger dated March 29, 2000* (12)
10(e)(i)	Agreement between the Company and Bruce Berger dated December 14, 2001* (13)
10(f)	Employee Stock Purchase Plan, as amended, of the Company (14)
10(g)	2000 Omnibus Stock Plan of the Company as Amended and Restated as of September 28, 2005*
10(h)	Digi International Inc. Non-Officer Stock Option Plan, as amended (15)
10(i)	NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan (16)
10(j)	NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (17)
10(k)	NetSilicon, Inc. 2001 Stock Option and Incentive Plan (18)
10(l)	Form of Notice of Grant of Stock Options and Option Agreement and Terms and Conditions of Nonstatutory Stock Option Agreement (19)
10(m)	Fiscal 2006 Executive Officer Compensation* (20)
10(n)	Amendments to Director Compensation* (20)
13	2005 Letter to Stockholders
14	Code of Ethics (21)
21	Subsidiaries of the Company
23	Consent of Independent Registered Public Accounting Firm
24	Powers of Attorney
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification

*Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

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ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (CONTINUED)

(1) Incorporated by reference to Annex A to the Company's Registration Statement on Form S-4 (File no. 333-74118).

(2) Incorporated by reference to Exhibit 2(a) to the Company's Form 10-Q for the quarter ended March 31, 2005 (File no. 0-17972).

(3) Incorporated by reference to Exhibit 2 to the Company's Form 8-K dated May 26, 2005 (File no. 0-17972).

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

(5) Incorporated by reference to Exhibit 3(b) to the Company's Form 10-K for the year ended September 30, 2001 (File no. 0-17972).

(6) Incorporated by reference of Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File no. 0-17972).

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

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

(9) Incorporated by reference to Exhibit 10(k) to the Company's Form 10-Q for the quarter ended March 31, 1999 (File no. 0-17972).

(10) Incorporated by reference to Exhibit 10(e) to the Company's Form 10-Q for the quarter ended December 31, 2000 (File no. 0-17972).

(11) Incorporated by reference to Exhibit 10(j) to the Company's Form 10-K for the year ended September 30, 1999 (File no. 0-17972).

(12) Incorporated by reference to Exhibit 10(g) to the Company's Form 10-K for the year ended September 30, 2000 (File no. 0-17972).

(13) Incorporated by reference to Exhibit 10(f) to the Company's Form 10-K for the year ended September 30, 2001 (File no. 0-17972).

(14) Incorporated by reference to Exhibit B to the Company's Proxy Statement for its Annual Meeting of Stockholders held on January 23, 2002 (File no. 0-17972).

(15) Incorporated by reference to Exhibit 10(a) to the Company's Form 10-Q for the quarter ended December 31, 2004 (File no. 0-17972).

(16) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82672).

(17) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82670).

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES (CONTINUED)

(18) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File no. 333-82668).

(19) Incorporated by reference to Exhibit 10(a) to the Company's Form 8-K dated September 13, 2004 (File no. 0-17972).

(20) Incorporated by reference to Item 1.01 of the Company's Form 8-K dated September 27, 2005 (File no. 0-17972)

(21) Incorporated by reference to Exhibit 14 to the Company's Form 10-K for the year ended September 30, 2003 (File no. 0-17972).

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SIGNATURES

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

DIGI INTERNATIONAL INC.

December 7, 2005

By: /s/ Joseph T. Dunsmore
Joseph T. Dunsmore
President, Chief Executive Officer, Chairman, and Director

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

December 7, 2005	/s/ Joseph T. Dunsmore Joseph T. Dunsmore President, Chief Executive Officer, Chairman, and Director (Principal Executive Officer)
December 7, 2005	/s/ Subramanian Krishnan Subramanian Krishnan Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)
GUY C. JACKSON **KENNETH E. MILLARD** **MYKOLA MOROZ** **WIILIAM N. PRIESMEYER** **BRADLEY J. WILLIAMS**	A majority of the Board of Directors*

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

December 7, 2005	/s/ Subramanian Krishnan Subramanian Krishnan Attorney-in-fact

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EXHIBIT INDEX

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2(b)	Purchase and assignment contract dated March 30, 2005 between Embedded Solutions AG, Klaus Flesch, Angelika Flesch and Digi International GmbH	Incorporated by Reference
2(c)	Agreement and plan of Merger among Digi International Inc., Karat Sub Inc. and Z-World, Inc. dated as of May 26, 2005 (excluding schedules and exhibits, which the Registrant agrees to furnish supplementally to the Securities and Exchange Commission upon request)	Incorporated by Reference
3(a)	Restated Certificate of Incorporation of the Company, as amended	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Company, as amended	Incorporated by Reference
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent	Incorporated by Reference
4(b)	Amendment dated January 26, 1999, to Shares Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent	Incorporated by Reference
10(a)	Stock Option Plan of the Company as Amended and Restated as of September 28, 2005	Filed Electronically
10(b)	Form of indemnification agreement with directors and officers of the Company	Incorporated by Reference
10(c)	Agreement between the Company and Subramanian Krishnan dated March 26, 1999	Incorporated by Reference
10(c)(i)	Amendment to the Agreement between the Company and Subramanian Krishnan dated February 5, 2001	Incorporated by Reference
10(d)	Employment Agreement between the Company and Joseph T. Dunsmore, dated October 24, 1999	Incorporated by Reference
10(e)	Agreement between the Company and Bruce Berger dated March 29, 2000	Incorporated by Reference
10(e)(i)	Agreement between the Company and Bruce Berger dated December 14, 2001	Incorporated by Reference
10(f)	Employee Stock Purchase Plan, as amended, of the Company	Incorporated by Reference
10(g)	2000 Omnibus Stock Plan of the Company as Amended and Restated as of September 28, 2005	Filed Electronically
10(h)	Digi International Inc. Non-Officer Stock Option Plan, as amended	Incorporated by Reference
10(i)	NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan	Incorporated by Reference
10(j)	NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan	Incorporated by Reference
10(k)	NetSilicon, Inc. 2001 Stock Option and Incentive Plan	Incorporated by Reference
10(l)	Form of Notice of Grant of Stock Options and Option Agreement and Terms and Conditions of Nonstatutory Stock Option Agreement	Incorporated by Reference
10(m)	Fiscal 2006 Executive Officer Compensation	Incorporated by Reference
10(n)	Amendments to Director Compensation	Incorporated by Reference

EXHIBIT INDEX (CONTINUED)

Exhibit	Description	Page
13	2005 Letter to Stockholders	Filed Electronically
14	Code of Ethics	Incorporated by Reference
21	Subsidiaries of the Company	Filed Electronically
23	Consent of Independent Registered Public Accounting Firm	Filed Electronically
24	Powers of Attorney	Filed Electronically
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

EXHIBIT 10(a)

DIGI INTERNATIONAL INC.

STOCK OPTION PLAN
AS AMENDED AND RESTATED
AS OF SEPTEMBER 28, 2005

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

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

3. Shares Subject to Plan. The shares that may be made subject to options granted under this Plan shall be authorized and unissued shares of common stock (the "Common Shares") of the Company, $.01 par value, or Common Shares held in treasury, and they shall not exceed 4,129,400 in the aggregate, except that, if any option lapses or terminates for any reason before such option has been completely exercised, the Common Shares

covered by the unexercised portion of such option may again be made subject to options granted under this Plan. Appropriate adjustments in the number of shares and in the purchase price per share may be made by the Committee in its sole discretion to give effect to adjustments made in the number of outstanding Common Shares of the Company through a merger, consolidation, recapitalization, reclassification, combination, stock dividend, stock split or other relevant change, provided that fractional shares shall be rounded to the nearest whole share.

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

5. Terms and Conditions of Employee Options.

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

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

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

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

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

(i) ten years after the date such option is granted (or in the case of an incentive stock option granted to a 10% Stockholder, five years after the date such option is granted) or on such date prior thereto as may be fixed by the Committee on or before the date such option is granted;

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

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

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

6. Terms and Conditions of Outside Director Options.

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

(i) each person who is elected to be an Outside Director and who was not at any time previously a director of the Company shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(i). The number of Common Shares covered by each such option shall be 7,500;

(ii) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders shall be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(ii). The number of Common Shares covered by each such option shall be 9,500;

(iii) each person who is elected to be an Outside Director between Annual Meetings of Stockholders shall be granted a nonstatutory stock option. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(iii). The number of Common Shares covered by each such option shall be 9,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12;

(iv) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders may elect in writing to be granted a nonstatutory stock option on the date of such Annual Meeting of Stockholders in lieu of all cash compensation to which such Outside Director would be entitled for the Board year of the Company commencing with such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for options granted pursuant to this subparagraph 6(a)(iv). The number of Common Shares covered by each such option shall be 3,500. Any such election by an Outside Director shall be subject to prior approval by the Committee; and

(v) each person who is elected to be an Outside Director between Annual Meetings of Stockholders may elect in writing to be granted a nonstatutory stock option in lieu of all cash compensation to which such Outside Director would otherwise be entitled for the period commencing with the date such person is elected to be an Outside Director of the Company by the Board and ending on the date of the next Annual Meeting of Stockholders. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such options granted pursuant to this subparagraph 6(a)(v). The number of Common Shares covered by each such option shall be 3,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12. Such election by an Outside Director shall be subject to prior approval by the Committee.

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

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

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

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

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

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

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

(i) ten years after the date such option is granted;

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

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

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

(f) The provisions of this Section 6 are not intended to be exclusive; the Committee, in its discretion, may grant additional Options to an Outside Director.

7. Manner of Exercising Options. A person entitled to exercise an option granted under this Plan may, subject to its terms and conditions and the terms and conditions of this Plan, exercise it in whole at any time, or in part from time to time, by delivery to the Company at its principal executive office, to the attention of its President, of written notice of exercise, specifying the number of shares with respect to which the option is being exercised, accompanied by payment in full of the purchase price of the shares to be purchased at the time. The purchase price of each share on the exercise of any option shall be paid in full in cash (including check, bank draft or money order) at the time of exercise or, at the discretion of the holder of the option, by delivery to the Company of unencumbered Common Shares having an aggregate Fair Market Value on the date of exercise equal to the purchase price, or by a combination of cash and such unencumbered Common Shares. Provided, however, that a person exercising a stock option shall not be permitted to pay any portion of the purchase price with stock if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company. No shares shall be issued until full payment therefor has been made, and the granting of an option to an individual shall give such individual no rights as a stockholder except as to shares issued to such individual.

8. Transferability and Termination of Options.

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

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

(i) unless otherwise provided in a stock option agreement, an option granted to an optionee who is not an Outside Director shall continue to be exercisable for three months after termination of such optionee's employment but, unless otherwise provided in a stock option agreement, only to the extent that the option was exercisable immediately prior to such optionee's termination of employment, and unless otherwise provided in a stock option agreement, an option granted to an optionee who is an Outside Director shall continue to be exercisable after such Outside Director ceases to be a director of the Company but, unless otherwise provided in a stock option agreement, only to the extent that the option was exercisable immediately prior to such Outside Director's ceasing to be a director;

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

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

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

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

9. Dissolution, Liquidation, Merger. In the event of (a) a proposed merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, unless appropriate provision shall have been made for the protection of the outstanding options granted under this Plan by the substitution, in lieu of such options, of options to purchase appropriate voting common stock (the "Survivor's Stock") of the corporation surviving any such merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation, or, alternatively, by the delivery of a number of shares of the Survivor's Stock which has a Fair Market Value as of the effective date of such merger or consolidation equal to the product of (i) the excess of (x) the Event Proceeds per Common Share (as hereinafter

defined) covered by the option as of such effective date, over (y) the option price per Common Share, times (ii) the number of Common Shares covered by such option, or (b) the proposed dissolution or liquidation of the Company (such merger, consolidation, dissolution or liquidation being herein called an "Event"), the Committee shall declare, at least ten days prior to the actual effective date of an Event, and provide written notice to each optionee of the declaration, that each outstanding option, whether or not then exercisable, shall be cancelled at the time of, or immediately prior to the occurrence of, the Event (unless it shall have been exercised prior to the occurrence of the Event) in exchange for payment to the holder of each cancelled option, within ten days after the Event, of cash equal to the amount (if any), for each Common Share covered by the cancelled option, by which the Event Proceeds per Common Share (as hereinafter defined) exceeds the exercise price per Common Share covered by such option. At the time of the declaration provided for in the immediately preceding sentence, each option shall immediately become exercisable in full and each holder of an option shall have the right, during the period preceding the time of cancellation of the option, to exercise his or her option as to all or any part of the Common Shares covered thereby. Each outstanding option granted pursuant to this Plan that shall not have been exercised prior to the Event shall be cancelled at the time of, or immediately prior to, the Event, as provided in the declaration, and this Plan shall terminate at the time of such cancellation, subject to the payment obligations of the Company provided in this paragraph 9. For purposes of this paragraph, "Event Proceeds per Common Share" shall mean the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Common Share by the stockholders of the Company upon the occurrence of the Event.

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

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

income arising from the exercise of the option, through a reduction of the number of Common Shares delivered to the person exercising the option or through a subsequent return to the Company of shares delivered to the person exercising the option.

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

13. Other Terms and Conditions. The Committee shall have the power, subject to the other limitations contained herein, to fix any other terms and conditions for the grant or exercise of any option under this Plan. Nothing contained in this Plan, or in any option granted pursuant to this Plan, shall confer upon any optionee any right to continued employment by the Company or any parent or subsidiary of the Company or limit in any way the right of the Company or any such parent or subsidiary to terminate an optionee's employment at any time.

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

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

(a) change the persons eligible to receive options;

(b) except as provided in paragraph 3 hereof, increase the total number of Common Shares of the Company which may be made subject to options granted under this Plan;

(c) except as provided in paragraph 3 hereof, change the minimum purchase price for the exercise of an option; or

(d) extend the term of this Plan beyond December 1, 2006.

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

16. Effective Date. This Plan shall be effective July 26, 1989.

EXHIBIT 10(g)

DIGI INTERNATIONAL INC.
2000 OMNIBUS STOCK PLAN
AS AMENDED AND RESTATED AS OF
SEPTEMBER 28, 2005

(EFFECTIVE AS OF NOVEMBER 6, 2000)

1. Purpose. The purpose of the Digi International Inc. 2000 Omnibus Stock Plan (the "Plan") is to promote the interests of the Company and its stockholders by providing key personnel of the Company and its Affiliates with an opportunity to acquire a proprietary interest in the Company and reward them for achieving a high level of corporate performance and thereby develop a stronger incentive to put forth maximum effort for the continued success and growth of the Company and its Affiliates. In addition, the opportunity to acquire a proprietary interest in the Company will aid in attracting and retaining key personnel of outstanding ability. The Plan is also intended to provide Outside Directors with an opportunity to acquire a proprietary interest in the Company, to compensate Outside Directors for their contribution to the Company and to aid in attracting and retaining Outside Directors.

2. Definitions.

2.1 The capitalized terms used elsewhere in the Plan have the meanings set forth below.

(a) "Affiliate" means any corporation that is a "parent corporation" or "subsidiary corporation" of the Company, as those terms are defined in Code Sections 424(e) and (f), or any successor provisions, and, for purposes other than the grant of Incentive Stock Options, any joint venture in which the Company or any such "parent corporation" or "subsidiary corporation" owns an equity interest.

(b) "Agreement" means a written contract (i) consistent with the terms of the Plan entered into between the Company or an Affiliate and a Participant and (ii) containing the terms and conditions of an Award in such form and not inconsistent with the Plan as the Committee shall approve from time to time, together with all amendments thereto, which amendments may be unilaterally made by the Company (with the approval of the Committee) unless such amendments are deemed by the Committee to be materially adverse to the Participant and not required as a matter of law.

(c) "Award" or "Awards" means a grant made under the Plan in the form of Restricted Stock, Options, Stock Appreciation Rights, Performance Units, Stock or any other stock-based award.

(d) "Board" means the Board of Directors of the Company.

(e) "Code" means the Internal Revenue Code of 1986, as amended and in effect from time to time or any successor statute.

(f) "Committee" means two or more Non-Employee Directors designated by the Board to administer the Plan under Plan Section 3.1 and constituted so as to permit grants thereby to comply with Exchange Act Rule 16b-3 and Code Section 162(m).

(g) "Company" means Digi International Inc., a Delaware corporation, or any successor to all or substantially all of its businesses by merger, consolidation, purchase of assets or otherwise.

(h) "Effective Date" means the date specified in Plan Section 12.1.

(i) "Employee" means an employee (including an officer or director who is also an employee) of the Company or an Affiliate.

(j) "Exchange Act" means the Securities Exchange Act of 1934, as amended and in effect from time to time or any successor statute.

(k) "Exchange Act Rule 16b-3" means Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as now in force and in effect from time to time or any successor regulation.

(l) "Fair Market Value" as of any date means, unless otherwise expressly provided in the Plan:

(i) the closing sale price of a Share on the date immediately preceding that date or, if no sale of Shares shall have occurred on that date, on the next preceding day on which a sale of Shares occurred

(A) on the composite tape for New York Stock Exchange listed shares, or

(B) if the Shares are not quoted on the composite tape for New York Stock Exchange listed shares, on the principal United States Securities Exchange registered under the Exchange Act on which the Shares are listed, or

(C) if the Shares are not listed on any such exchange, on the National Association of Securities Dealers, Inc. Automated Quotations National Market System or any system then in use, or

(ii) if clause (i) is inapplicable, the mean between the closing "bid" and the closing "asked" quotation of a Share on the date immediately preceding that date, or, if no closing bid or asked quotation is made on that date, on the next preceding day on which a closing bid and asked quotation is made, on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or

(iii) if clauses (i) and (ii) are inapplicable, what the Committee determines in good faith to be 100% of the fair market value of a Share on that date, using such criteria as it shall determine, in its sole discretion, to be appropriate for valuation.

However, if the applicable securities exchange or system has closed for the day at the time the event occurs that triggers a determination of Fair Market Value, whether the grant of an Award, the exercise of an Option or Stock Appreciation Right or otherwise, all references in this paragraph to the "date immediately preceding that date" shall be deemed to be references to "that date." In the case of an Incentive Stock Option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 16.

(m) "Fundamental Change" means a dissolution or liquidation of the Company, a sale of substantially all of the assets of the Company, a merger or consolidation of the Company with or into any other corporation, regardless of whether the Company is the surviving corporation, or a statutory share exchange involving capital stock of the Company.

(n) "Incentive Stock Option" means any Option designated as such and granted in accordance with the requirements of Code Section 422 or any successor provision.

(o) "Insider" as of a particular date means any person who, as of that date is an officer of the Company as defined under Exchange Act Rule 16a-1(f) or its successor provision.

(p) "Non-Employee Director" means a member of the Board who is considered a non-employee director within the meaning of Exchange Act Rule 16b-3(b)(3) or its successor provision and an outside director for purposes of Code Section 162(m).

(q) "Non-Statutory Stock Option" means an Option other than an Incentive Stock Option.

(r) "Option" means a right to purchase Stock, including both Non-Statutory Stock Options and Incentive Stock Options.

(s) "Outside Director" means a director who is not an Employee.

(t) "Participant" means a person or entity to whom an Award is or has been made in accordance with the Plan.

(u) "Performance Cycle" means the period of time as specified in an Agreement over which Performance Units are to be earned.

(v) "Performance Units" means an Award made pursuant to Plan Section 11.

(w) "Plan" means this Digi International Inc. 2000 Omnibus Stock Plan, as may be amended and in effect from time to time.

(x) "Restricted Stock" means Stock granted under Plan Section 7 so long as such Stock remains subject to one or more restrictions.

(y) "Section 16" or "Section 16(b)" means Section 16 or Section 16(b), respectively, of the Exchange Act or any successor statute and the rules and regulations promulgated thereunder as in effect and as amended from time to time.

(z) "Share" means a share of Stock.

(aa) "Stock" means the common stock, par value $.01 per share, of the Company.

(bb) "Stock Appreciation Right" means a right, the value of which is determined in relation to the appreciation in value of Shares pursuant to an Award granted under Plan Section 10.

(cc) "Subsidiary" means a "subsidiary corporation," as that term is defined in Code Section 424(f) or any successor provision.

(dd) "Successor" with respect to a Participant means the legal representative of an incompetent Participant, and if the Participant is deceased the estate of the Participant or the person or persons who may, by bequest or inheritance, or pursuant to the terms of an Award, acquire the right to exercise an Option or Stock Appreciation Right or to receive cash and/or Shares issuable in satisfaction of an Award in the event of the Participant's death.

(ee) "Term" means the period during which an Option or Stock Appreciation Right may be exercised or the period during which the restrictions or terms and conditions placed on Restricted Stock or any other Award are in effect.

(ff) "Transferee" means any member of the Participant's immediate family (i.e., his or her children, step-children, grandchildren and spouse) or one or more trusts for the benefit of such family members or partnerships in which such family members are the only partners.

2.2 Gender and Number. Except when otherwise indicated by the context, reference to the masculine gender shall include, when used, the feminine gender and any term used in the singular shall also include the plural.

3. Administration and Indemnification.

3.1 Administration.

(a) The Committee shall administer the Plan. The Committee shall have exclusive power to (i) make Awards, (ii) determine when and to whom Awards will be granted, the form of each Award, the amount of each Award (except as to the amount of the Outside Director Options pursuant to Plan Section 9.3), and any other terms or conditions of each Award consistent with the Plan, and (iii) determine whether, to what extent and under what circumstances, Awards may be settled, paid or exercised in cash, Shares or other Awards, or other property or canceled, forfeited or suspended. Each Award shall be subject to an Agreement authorized by the Committee. A majority of the members of the Committee shall constitute a quorum for any meeting of the Committee, and acts of a majority of the members present at any meeting at which a quorum is present or the acts unanimously approved in writing by all members of the Committee shall be the acts of the Committee. Notwithstanding the foregoing, the Board shall have the sole and exclusive power to administer the Plan with respect to Awards granted to Outside Directors, including any grants made under Plan Section 9.3(e).

(b) Solely for purposes of determining and administering Awards to Participants who are not Insiders, the Committee may delegate all or any portion of its authority under the Plan to one or more persons who are not Non-Employee Directors.

(c) To the extent within its discretion and subject to Plan Sections 15 and 16, other than price, the Committee may amend the terms and conditions of any outstanding Award.

(d) It is the intent that the Plan and all Awards granted pursuant to it shall be administered by the Committee so as to permit the Plan and Awards to comply with Exchange Act Rule 16b-3, except in such instances as the Committee, in its discretion, may so provide. If any provision of the Plan or of any Award would otherwise frustrate or conflict with the intent expressed in this Section 3.1(d), that provision to the extent possible shall be interpreted and deemed amended in the manner determined by the Committee so as to avoid the conflict. To the extent of any remaining irreconcilable conflict with this intent, the provision shall be deemed void as applicable to Insiders to the extent permitted by law and in the manner deemed advisable by the Committee.

(e) The Committee's interpretation of the Plan and of any Award or Agreement made under the Plan and all related decisions or resolutions of the Board or Committee shall be final and binding on all parties with an interest therein. Consistent with its terms, the Committee shall have the power to establish, amend or waive regulations to administer the Plan. In carrying out any of its responsibilities, the Committee shall have discretionary authority to construe the terms of the Plan and any Award or Agreement made under the Plan.

3.2 Indemnification. Each person who is or shall have been a member of the Committee, or of the Board, and any other person to whom the Committee delegates authority under the Plan, shall be indemnified and held harmless by the Company, to the extent permitted by law, against and from any loss, cost, liability or expense that may be imposed upon or reasonably incurred by such person in connection with or resulting from any claim, action, suit or proceeding to which such person may be a party or in which such person may be involved by reason of any action taken or failure to act, made in good faith, under the Plan and against and from any and all amounts paid by such person in settlement thereof, with the Company's approval, or paid by such person in satisfaction of any judgment in any such action, suit or proceeding against such person, provided such person shall give the Company an opportunity, at the Company's expense, to handle and defend the same before such person undertakes to handle and defend it on such person's own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person or persons may be entitled under the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

4. Shares Available Under the Plan.

(a) The number of Shares available for distribution under the Plan shall not exceed 750,000 (subject to adjustment pursuant to Plan Section 16).

(b) Any Shares subject to the terms and conditions of an Award under the Plan that are not used because the terms and conditions of the Award are not met may again be used for an Award under the Plan; provided however, that Shares with respect to which a Stock Appreciation Right has been exercised whether paid in cash and/or in Shares may not again be awarded under the Plan.

(c) Any unexercised or undistributed portion of any terminated, expired, exchanged, or forfeited Award, or any Award settled in cash in lieu of Shares (except as provided in Plan Section 4(b)) shall be available for further Awards.

(d) For the purposes of computing the total number of Shares granted under the Plan, the following rules shall apply to Awards payable in Shares where appropriate:

(i) each Option shall be deemed to be the equivalent of the maximum number of Shares that may be issued upon exercise of the particular Option;

(ii) an Award (other than an Option) payable in some other security shall be deemed to be equal to the number of Shares to which it relates;

(iii) where the number of Shares available under the Award is variable on the date it is granted, the number of Shares shall be deemed to be the maximum number of Shares that could be received under that particular Award; and

(iv) where two or more types of Awards (all of which are payable in Shares) are granted to a Participant in tandem with each other, such that the exercise of one type of Award with respect to a number of Shares cancels at least an equal number of Shares of the other, each such joint Award shall be deemed to be the equivalent of the maximum number of Shares available under the largest single Award.

Additional rules for determining the number of Shares granted under the Plan may be made by the Committee as it deems necessary or desirable.

(e) No fractional Shares may be issued under the Plan; however, cash shall be paid in lieu of any fractional Share in settlement of an Award.

(f) The maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Options is 250,000 and the maximum number of Shares that may be awarded to a Participant in any calendar year in the form of Stock Appreciation Rights is 100,000.

5. Eligibility. Participation in the Plan shall be limited to Employees and to individuals or entities who are not Employees but who provide services to the Company or an Affiliate, including services provided in the capacity of a consultant, advisor or director. The granting of Awards is solely at the discretion of the Committee, except that Incentive Stock Options may only be granted to Employees and except for certain

Awards to Outside Directors pursuant to Plan Section 9.3. References herein to "employed," "employment" or similar terms (except "Employee") shall include the providing of services in any capacity or as a director. Neither the transfer of employment of a Participant between any of the Company or its Affiliates, nor a leave of absence granted to such Participant and approved by the Committee, shall be deemed a termination of employment for purposes of the Plan.

6. General Terms of Awards.

6.1 Amount of Award. Each Agreement shall set forth the number of Shares of Restricted Stock, Stock or Performance Units subject to the Agreement, or the number of Shares to which the Option subject to the Agreement applies or with respect to which payment upon the exercise of the Stock Appreciation Right subject to the Agreement is to be determined, as the case may be, together with such other terms and conditions applicable to the Award as determined by the Committee acting in its sole discretion.

6.2 Term. Each Agreement, other than those relating solely to Awards of Shares without restrictions, shall set forth the Term of the Option, Stock Appreciation Right, Restricted Stock or other Award or the Performance Cycle for the Performance Units, as the case may be. Acceleration of the expiration of the applicable Term is permitted, upon such terms and conditions as shall be set forth in the Agreement, which may, but need not, include, without limitation, acceleration in the event of the Participant's death or retirement. Acceleration of the Performance Cycle of Performance Units shall be subject to Plan Section 11.2.

6.3 Transferability. Except as provided in this Section, during the lifetime of a Participant to whom an Award is granted, only that Participant (or that Participant's legal representative) may exercise an Option or Stock Appreciation Right, or receive payment with respect to Performance Units or any other Award. No Award of Restricted Stock (before the expiration of the restrictions), Options, Stock Appreciation Rights or Performance Units or other Award may be sold, assigned, transferred, exchanged or otherwise encumbered other than to a Successor in the event of a Participant's death or pursuant to a qualified domestic relations order as defined in the Code or Title 1 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or the rules thereunder; any attempted transfer in violation of this Section 6.3 shall be of no effect. Notwithstanding the immediately preceding sentence, the Committee, in an Agreement or otherwise at its discretion, may provide that the Award (other than Incentive Stock Options) may be transferable to a Transferee if the Participant does not receive any consideration for the transfer. Any Award held by a Transferee shall continue to be subject to the same terms and conditions that were applicable to that Award immediately before the transfer thereof to the Transferee. For purposes of any provision of the Plan relating to notice to a Participant or to acceleration or termination of an Award upon the death, disability or termination of employment of a Participant (or, in the case of Plan

Section 9.3, an Outside Director) the references to "Participant" (or "Outside Director") shall mean the original grantee of an Award and not any Transferee.

6.4 Termination of Employment. Except as otherwise determined by the Committee or provided by the Committee in an Agreement, in case of a Participant's termination of employment, the following provisions shall apply:

(a) Options and Stock Appreciation Rights.

(i) If a Participant's employment or other relationship with the Company and its Affiliates terminates because of the Participant's death, then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and a date not more than three months prior to such death, and may be exercised by the Participant's Successor at any time, or from time to time, within one year after the date of the Participant's death.

(ii) If a Participant's employment or other relationship with the Company and its Affiliates terminates because the Participant is disabled (within the meaning of Section 22(e)(3) of the Code), then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and the date of such disability, and the Participant or the Participant's Successor may exercise such Option or Stock Appreciation Right at any time, or from time to time, within one year after the date of the Participant's disability.

(iii) If a Participant's employment terminates for any reason other than death or disability, then any Option or Stock Appreciation Right that has not expired or been terminated shall remain exercisable for three months after termination of the Participant's employment, but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Participant's termination of employment; provided, however, that if the Participant is an Outside Director, the Option or Stock Appreciation Right shall remain exercisable until the expiration of the Term after such Outside Director ceases to be a director of the Company but, unless otherwise provided in the Agreement, only to the extent that such

Option or Stock Appreciation Right was exercisable immediately prior to such Outside Director ceasing to be a director.

(iv) Notwithstanding the foregoing Plan Sections 6.4(a)(i), (ii) and (iii), in no event shall an Option or a Stock Appreciation Right be exercisable after the expiration of the Term of such Award. Any Option or Stock Appreciation Right that is not exercised within the periods set forth in Plan Sections 6.4 (i), (ii) and (iii), except as otherwise provided by the Committee in the Agreement, shall terminate as of the end of the periods described in such Sections.

(b) Performance Units. If a Participant's employment or other relationship with the Company and its Affiliates terminates during a Performance Cycle because of death or disability, or under other circumstances provided by the Committee in its discretion in the Agreement or otherwise, the Participant, unless the Committee shall otherwise provide in the Agreement, shall be entitled to a payment with respect to Performance Units at the end of the Performance Cycle based upon the extent to which achievement of performance targets was satisfied at the end of such period (as determined at the end of the Performance Cycle) and prorated for the portion of the Performance Cycle during which the Participant was employed by the Company or its Affiliates. Except as provided in this Section 6.4(b) or in the Agreement, if a Participant's employment or other relationship with the Company and its Affiliates terminates during a Performance Cycle, then such Participant shall not be entitled to any payment with respect to that Performance Cycle.

(c) Restricted Stock Awards. Unless otherwise provided in the Agreement, in case of a Participant's death or disability, the Participant shall be entitled to receive a number of Shares of Restricted Stock under outstanding Awards that has been prorated for the portion of the Term of the Awards during which the Participant was employed by the Company and its Affiliates, and, with respect to such Shares, all restrictions shall lapse. Any Shares of Restricted Stock as to which restrictions do not lapse under the preceding sentence shall terminate at the date of the Participant's termination of employment and such Shares of Restricted Stock shall be forfeited to the Company.

6.5 Rights as Stockholder. Each Agreement shall provide that a Participant shall have no rights as a stockholder with respect to any securities covered by an Award unless and until the date the Participant becomes the holder of record of the Stock, if any, to which the Award relates.

7. Restricted Stock Awards.

(a) An Award of Restricted Stock under the Plan shall consist of Shares subject to restrictions on transfer and conditions of forfeiture, which restrictions and conditions shall be included in the applicable Agreement. The Committee may provide for the lapse or waiver of any such restriction or condition based on such factors or criteria as the Committee, in its sole discretion, may determine.

(b) Except as otherwise provided in the applicable Agreement, each Stock certificate issued with respect to an Award of Restricted Stock shall either be deposited with the Company or its designee, together with an assignment separate from the certificate, in blank, signed by the Participant, or bear such legends with respect to the restricted nature of the Restricted Stock evidenced thereby as shall be provided for in the applicable Agreement.

(c) The Agreement shall describe the terms and conditions by which the restrictions and conditions of forfeiture upon awarded Restricted Stock shall lapse. Upon the lapse of the restrictions and conditions, Shares free of restrictive legends, if any, relating to such restrictions shall be issued to the Participant or a Successor or Transferee.

(d) A Participant or a Transferee with a Restricted Stock Award shall have all the other rights of a stockholder including, but not limited to, the right to receive dividends and the right to vote the Shares of Restricted Stock.

(e) No more than 100,000 of the total number of Shares available for Awards under the Plan shall be issued during the term of the Plan as Restricted Stock. This limitation shall be calculated pursuant to the applicable provisions of Plan Sections 4 and 16.

8. Other Awards. The Committee may from time to time grant Stock and other Awards under the Plan including, without limitation, those Awards pursuant to which Shares are or may in the future be acquired, Awards denominated in Stock units, securities convertible into Stock and phantom securities. The Committee, in its sole discretion, shall determine the terms and conditions of such Awards provided that such Awards shall not be inconsistent with the terms and purposes of the Plan. The Committee may, at its sole discretion, direct the Company to issue Shares subject to restrictive legends and/or stop transfer instructions that are consistent with the terms and conditions of the Award to which the Shares relate. No more than 50,000 of the total number of Shares available for Awards under the Plan shall be issued during the term of the Plan in the form of Stock without restrictions.

9. Stock Options.

9.1 Terms of All Options.

(a) An Option shall be granted pursuant to an Agreement as either an Incentive Stock Option or a Non-Statutory Stock Option. The purchase price of each Share subject to an Option shall be determined by the Committee and set forth in the Agreement, but shall not be less than 50% of the Fair Market Value of a Share as of the date the Option is granted (except as provided in Plan Sections 9.2 and 19).

(b) The purchase price of the Shares with respect to which an Option is exercised shall be payable in full at the time of exercise, provided that to the extent permitted by law, the Agreement may permit some or all Participants to simultaneously exercise Options and sell the Shares thereby acquired pursuant to a brokerage or similar relationship and use the proceeds from the sale as payment of the purchase price of the Shares. The purchase price may be payable in cash, by delivery or tender of Shares having a Fair Market Value as of the date the Option is exercised equal to the purchase price of the Shares being purchased pursuant to the Option, or a combination thereof, as determined by the Committee, but no fractional Shares will be issued or accepted. Provided, however, that a Participant exercising a stock option shall not be permitted to pay any portion of the purchase price with Shares if, in the opinion of the Committee, payment in such manner could have adverse financial accounting consequences for the Company.

(c) The Committee may provide, in an Agreement or otherwise, that a Participant who exercises an Option and pays the Option price in whole or in part with Shares then owned by the Participant will be entitled to receive another Option covering the same number of shares tendered and with a price of no less than Fair Market Value on the date of grant of such additional Option ("Reload Option"). Unless otherwise provided in the Agreement, a Participant, in order to be entitled to a Reload Option, must pay with Shares that have been owned by the Participant for at least the preceding 180 days.

(d) Each Option shall be exercisable in whole or in part on the terms provided in the Agreement. In no event shall any Option be exercisable at any time after the expiration of its Term. When an Option is no longer exercisable, it shall be deemed to have lapsed or terminated.

9.2 Incentive Stock Options. In addition to the other terms and conditions applicable to all Options:

(i) the purchase price of each Share subject to an Incentive Stock Option shall not be less than 100% of the Fair Market Value of a Share as of the date the Incentive Stock Option is granted if this limitation is necessary to qualify the Option as an Incentive Stock Option (except as provided in Plan Section 19);

(ii) the aggregate Fair Market Value (determined as of the date the Option is granted) of the Shares with respect to which Incentive Stock Options held by an individual first become exercisable in any calendar year (under the Plan and all other incentive stock option plans of the Company and its Affiliates) shall not exceed $100,000 (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option and to the extent an Option or Options granted to a Participant exceed this limit the Option or Options shall be treated as a Non-Statutory Stock Option;

(iii) an Incentive Stock Option shall not be exercisable more than 10 years after the date of grant (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option;

(iv) the Agreement covering an Incentive Stock Option shall contain such other terms and provisions that the Committee determines necessary to qualify this Option as an Incentive Stock Option; and

(v) notwithstanding any other provision of the Plan to the contrary, no Participant may receive an Incentive Stock Option under the Plan if, at the time the Award is granted, the Participant owns (after application of the rules contained in Code Section 424(d), or its successor provision), Shares possessing more than 10% of the total combined voting power of all classes of stock of the Company or its Subsidiaries, unless (i) the option price for that Incentive Stock Option is at least 110% of the Fair Market Value of the Shares subject to that Incentive Stock Option on the date of grant and (ii) that Option is not exercisable after the date five years from the date that Incentive Stock Option is granted.

9.3 Terms and Conditions of Outside Director Options. This Section 9.3 shall apply from and after the earlier of the date of termination of the Digi International Inc. Stock Option Plan or the date on which no Shares remain available for issuance thereunder.

(a) Outside Director Option Grants. Subject to the terms and conditions of the Plan, the Committee shall grant Options to each Outside Director who is not on the date such Option would be granted the beneficial owner (as defined in Rule 13d-3 under the Exchange Act) of more than 5% of the outstanding Shares, on the terms and conditions set forth in this Section 9.3. During the term of the Plan and provided that sufficient Shares are available pursuant to Plan Section 4:

(i) each person who is elected to be an Outside Director and who was not at any time previously a director of the Company shall be granted a Non-Statutory Stock Option. The date such person is elected to be an Outside Director of the Company shall be the date of grant for such Options granted pursuant to this Section 9.3(a)(i). The number of Shares covered by each such Option shall be 7,500;

(ii) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders shall be granted a Non-Statutory Stock Option on the date of such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for Options granted pursuant to this Section 9.3(a)(ii). The number of Shares covered by each such Option shall be 9,500;

(iii) each person who is elected to be an Outside Director between Annual Meetings of Stockholders shall be granted a Non-Statutory Stock Option. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such Options granted pursuant to this Section 9.3(a)(iii). The number of Shares covered by each such Option shall be 9,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12;

(iv) each person who is an Outside Director at the conclusion of an Annual Meeting of Stockholders may elect in writing to be granted a Non-Statutory Stock Option on the date of such Annual Meeting of Stockholders in lieu of all cash compensation to which such Outside Director would be entitled for the Board year of the Company commencing with such Annual Meeting of Stockholders. The date of such Annual Meeting of Stockholders shall also be the date of grant for Options granted pursuant to this Section 9.3(a)(iv). The number of Shares covered by each such Option shall be 3,500. Any such election by an Outside Director shall be subject to prior approval by the Committee; and

(v) each person who is elected to be an Outside Director between Annual Meetings of Stockholders may elect in writing to be granted a Non-Statutory Stock Option in lieu of all cash compensation to which such Outside Director would otherwise be entitled for the period commencing with the date such person is elected to be an Outside Director of the Company by the Board and ending on the date of the next Annual Meeting of Stockholders. The date such person is elected to be an Outside Director of the Company by the Board shall be the date of grant for such Options granted pursuant to this Section 9.3(a)(v). The number of Shares covered by each such Option shall be 3,500 multiplied by a fraction, the numerator of which shall be 12 minus the number of whole 30-day months that have elapsed from the date of the most recent Annual Meeting of Stockholders to the date such person is elected to be an Outside Director, and the denominator of which shall be 12. Such election by an Outside Director shall be subject to prior approval by the Committee.

(b) Exercise Price of Outside Director Options. The purchase price of each Share subject to an Option granted to an Outside Director pursuant to this Section 9.3 shall be the Fair Market Value of a Share on the date of grant.

(c) Vesting of Outside Director Options.

(i) Subject to the provisions of Plan Sections 9.3(d) and (e), (x) options granted to Outside Directors pursuant to Plan Sections 9.3(a)(ii) and (iv) and (y) options granted to Outside Directors pursuant to Plan Section 9.3(a)(i) if the date of grant of such Options is the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

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

(ii) Subject to the provisions of Plan Sections 9.3(d) and (e), (x) the options granted to Outside Directors pursuant to Plan Sections 9.3(a)(iii) and (v) and (y) options granted to Outside Directors pursuant to Plan Section 9.3(a)(i) if the date of grant of such Options is a date other than the date of an Annual Meeting of Stockholders shall vest and become exercisable in accordance with the following schedule:

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

(d) Accelerated Vesting of Outside Director Options. Notwithstanding the vesting schedules set forth in Plan Section 9.3(c), an Option held by an Outside Director shall vest and become immediately exercisable upon the latest of (i) the date on which such Outside Director attains 62 years of age, (ii) the date on which such Outside Director has completed five years of Service (as hereinafter defined) and (iii) the first anniversary of the date of grant of such Option or, if applicable, the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such Option was granted. Any Option granted to an Outside Director on or after the first accelerated vesting date for such Outside Director shall automatically vest on the Annual Meeting of Stockholders next succeeding the Annual Meeting at which such Option was granted. As used herein, "Service" shall mean service to the Company or an Affiliate in the capacity of any advisor, consultant, employee, officer or director, and Service as a director from an Annual Meeting of Stockholders to the next succeeding Annual Meeting shall constitute a year of Service, notwithstanding that such period may actually be more or less than one year.

(e) Non-exclusivity of Section 9.3. The provisions of this Section 9.3 are not intended to be exclusive; the Committee, in its discretion, may grant Options or other Awards to an Outside Director.

10. Stock Appreciation Rights. An Award of a Stock Appreciation Right shall entitle the Participant (or a Successor or Transferee), subject to terms and conditions determined by the Committee, to receive upon exercise of the Stock Appreciation Right all or a portion of the excess of (i) the Fair Market Value of a specified number of Shares as of the date of exercise of the Stock Appreciation Right over (ii) a specified price that shall not be less than 100% of the Fair Market Value of such Shares as of the date of grant of the Stock Appreciation Right. A Stock Appreciation Right may be granted in connection with part or all of, in addition to, or completely independent of an Option or any other Award under the Plan. If issued in connection with a previously or contemporaneously granted Option, the Committee may impose a condition that exercise of a Stock Appreciation Right cancels a pro rata portion of the Option with which it is connected and vice versa. Each Stock Appreciation Right may be exercisable in whole or in part on the terms provided in the Agreement. No Stock Appreciation Right shall be exercisable at any time after the expiration of its Term. When a Stock Appreciation Right is no longer exercisable, it shall be deemed to have lapsed or terminated. Upon exercise of a Stock Appreciation Right, payment to the Participant or a Successor or Transferee shall be made at such time or times as shall be provided in the Agreement in the form of cash, Shares or a combination of cash and Shares as determined by the Committee. The Agreement may provide for a limitation upon the amount or percentage of the total appreciation on which payment (whether in cash and/or Shares) may be made in the event of the exercise of a Stock Appreciation Right.

11. Performance Units.

11.1 Initial Award.

(a) An Award of Performance Units under the Plan shall entitle the Participant or a Successor or Transferee to future payments of cash, Shares or a combination of cash and Shares, as determined by the Committee, based upon the achievement of pre-established performance targets. These performance targets may, but need not, include, without limitation, targets relating to one or more of the Company's or a group's, unit's, Affiliate's or an individual's performance. The Agreement may establish that a portion of a Participant's Award will be paid for performance that exceeds the minimum target but falls below the maximum target applicable to the Award. The Agreement shall also provide for the timing of the payment.

(b) Following the conclusion or acceleration of each Performance Cycle, the Committee shall determine the extent to which (i) performance targets have been attained, (ii) any other terms and conditions with respect to an Award relating to the Performance Cycle have been satisfied and (iii) payment is due with respect to an Award of Performance Units.

11.2 Acceleration and Adjustment. The Agreement may permit an acceleration of the Performance Cycle and an adjustment of performance targets and payments with respect to some or all of the Performance Units awarded to a Participant, upon the occurrence of certain events, which may, but need not include, without limitation, a Fundamental Change, a recapitalization, a change in the accounting practices of the Company, a change in the Participant's title or employment responsibilities, the Participant's death or retirement or, with respect to payments in Shares with respect to Performance Units, a reclassification, stock dividend, stock split or stock combination as provided in Plan Section 16. The Agreement also may provide for a limitation on the value of an Award of Performance Units that a Participant may receive.

12. Effective Date and Duration of the Plan.

12.1 Effective Date. The Plan shall become effective as of November 6, 2000, provided that the Plan is approved by the requisite vote of stockholders at the January 2001 Annual Meeting of Stockholders or any adjournment thereof.

12.2 Duration of the Plan. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 15, or November 6, 2010 (the "Termination Date"); provided, however, that Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date unless limited in the Agreement or otherwise. No Award of an Incentive Stock Option shall be made more than 10 years after the Effective Date (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. The date and time of approval by the Committee of the granting of an Award shall be considered the date and time at which the Award is made or granted.

13. Plan Does Not Affect Employment Status.

(a) Status as an eligible Employee shall not be construed as a commitment that any Award will be made under the Plan to that eligible Employee or to eligible Employees generally.

(b) Nothing in the Plan or in any Agreement or related documents shall confer upon any Employee or Participant any right to continue in the employment of the Company or any Affiliate or constitute any contract of employment or affect any right that the Company or any Affiliate may have to change such person's compensation, other benefits, job responsibilities, or title, or to terminate the employment of such person with or without cause.

14. Tax Withholding. The Company shall have the right to withhold from any cash payment under the Plan to a Participant or other person (including a Successor or a Transferee) an amount sufficient to cover any required withholding taxes. The Company shall have the right to require a Participant or other person receiving Shares under the Plan to pay the Company a cash amount sufficient to cover any required withholding taxes before actual receipt of those Shares. In lieu of all or any part of a cash payment from a person receiving Shares under the Plan, the Committee may permit the individual to cover all or any part of the required withholdings through a reduction of the number of Shares delivered or delivery or tender return to the Company of Shares held by the Participant or other person, in each case valued in the same manner as used in computing the withholding taxes under the applicable laws.

15. Amendment, Modification and Termination of the Plan.

(a) The Board may at any time and from time to time terminate, suspend or modify the Plan. Except as limited in (b) below, the Committee may at any time alter or amend any or all Agreements under the Plan to the extent permitted by law.

(b) No termination, suspension, or modification of the Plan will materially and adversely affect any right acquired by any Participant or Successor or Transferee under an Award granted before the date of termination, suspension, or modification, unless otherwise agreed to by the Participant in the Agreement or otherwise, or required as a matter of law; but it will be conclusively presumed that any adjustment for changes in capitalization provided for in Plan Sections 11.2 or 16 does not adversely affect these rights.

16. Adjustment for Changes in Capitalization. Subject to any required action by the Company's stockholders, appropriate adjustments, so as to prevent enlargement of rights or inappropriate dilution -- (i) in the aggregate number and type of Shares available for Awards under the Plan, (ii) in the limitations on the number of Shares that may be issued to an individual Participant as an Option or a Stock Appreciation Right in any calendar year or that may be issued in the form of Restricted Stock or Shares without restrictions, (iii) in the number and type of Shares and amount of cash subject to Awards then outstanding, (iv) in the Option price as to any outstanding Options and, (v) subject to Plan Section 11.2, in outstanding Performance Units and payments with respect to outstanding Performance Units -- may be made by the Committee in its sole discretion to give effect to adjustments made in the number or type of Shares through a Fundamental Change (subject to Plan Section 17), recapitalization, reclassification, stock dividend, stock split, stock combination or other relevant change, provided that fractional Shares shall be rounded to the nearest whole Share.

17. Fundamental Change. In the event of a proposed Fundamental Change, the Committee may, but shall not be obligated to:

(a) if the Fundamental Change is a merger or consolidation or statutory share exchange, make appropriate provision for the protection of the outstanding Options and Stock Appreciation Rights by the substitution of options, stock appreciation rights and appropriate voting common stock of the corporation surviving any merger or consolidation or, if appropriate, the parent corporation of the Company or such surviving corporation; or

(b) at least ten days before the occurrence of the Fundamental Change, declare, and provide written notice to each holder of an Option or Stock Appreciation Right of the declaration, that each outstanding Option and Stock Appreciation Right, whether or not then exercisable, shall be canceled at the time of, or immediately before the occurrence of the Fundamental Change in exchange for payment to each holder of an Option or Stock Appreciation Right, within ten days after the Fundamental Change, of cash equal to (i) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section) per Share exceeds the exercise price per Share covered by such Option or (ii) for each Stock Appreciation Right, the price determined pursuant to Section 10, except that Fair Market Value of the Shares as of the date of exercise of the Stock Appreciation Right, as used in clause (i) of Plan Section 10, shall be deemed to mean Fair Market Value for each Share with respect to which the Stock Appreciation Right is calculated determined in the manner hereinafter referred to in this Section. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option shall immediately become exercisable in full and each person holding an Option or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option or Stock Appreciation Right, to exercise the Option as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to Plan Section 17(b), each outstanding Option and Stock

Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Fundamental Change shall be canceled at the time of, or immediately before, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, no person holding an Option or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 17(b) if such Option or Stock Appreciation Right shall have terminated, expired or been cancelled. For purposes of this Section only, "Fair Market Value" per Share means the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the stockholders of the Company upon the occurrence of the Fundamental Change.

18. Forfeitures. An Agreement may provide that if a Participant has received or been entitled to payment of cash, delivery of Shares, or a combination thereof pursuant to an Award within six months before the Participant's termination of employment with the Company and its Affiliates, the Committee, in its sole discretion, may require the Participant to return or forfeit the cash and/or Shares received with respect to the Award (or its economic value as of (i) the date of the exercise of Options or Stock Appreciation Rights, (ii) the date of, and immediately following, the lapse of restrictions on Restricted Stock or the receipt of Shares without restrictions, or (iii) the date on which the right of the Participant to payment with respect to Performance Units vests, as the case may be) in the event of certain occurrences specified in the Agreement. The Committee's right to require forfeiture must be exercised within 90 days after discovery of such an occurrence but in no event later than 15 months after the Participant's termination of employment with the Company and its Affiliates. The occurrences may, but need not, include competition with the Company or any Affiliate, unauthorized disclosure of material proprietary information of the Company or any Affiliate, a violation of applicable business ethics policies of the Company or Affiliate or any other occurrence specified in the Agreement within the period or periods of time specified in the Agreement.

19. Corporate Mergers, Acquisitions, Etc. The Committee may also grant Options, Stock Appreciation Rights, Restricted Stock or other Awards under the Plan in substitution for, or in connection with the assumption of, existing options, stock appreciation rights, restricted stock or other award granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to which the Company or a Subsidiary is a party. The terms and conditions of the substitute Awards may vary from the terms and conditions set forth in the Plan to the extent as the Board at the time of the grant may deem appropriate to conform, in whole or in part, to the provisions of the awards in substitution for which they are granted.

20. Unfunded Plan. The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, its Affiliates, the Committee, nor the Board of Directors shall be deemed to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and/or its Affiliates,

and a Participant or Successor or Transferee. To the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

21. Limits of Liability.

(a) Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligations created by the Plan and the Award Agreement.

(b) Except as may be required by law, neither the Company nor any member of the Board of Directors or of the Committee, nor any other person participating in any determination of any question under the Plan, or in the interpretation, administration or application of the Plan, shall have any liability to any party for any action taken, or not taken, in good faith under the Plan.

22. Compliance with Applicable Legal Requirements. No certificate for Shares distributable pursuant to the Plan shall be issued and delivered unless the issuance of the certificate complies with all applicable legal requirements including, without limitation, compliance with the provisions of applicable state securities laws, the Securities Act of 1933, as amended and in effect from time to time or any successor statute, the Exchange Act and the requirements of the exchanges on which the Company's Shares may, at the time, be listed.

23. Deferrals and Settlements. The Committee may require or permit Participants to elect to defer the issuance of Shares or the settlement of Awards in cash under such rules and procedures as it may establish under the Plan. It may also provide that deferred settlements include the payment or crediting of interest on the deferral amounts.

24. Other Benefit and Compensation Programs. Payments and other benefits received by a Participant under an Award made pursuant to the Plan shall not be deemed a part of a Participant's regular, recurring compensation for purposes of the termination, indemnity or severance pay laws of any country and shall not be included in, nor have any effect on, the determination of benefits under any other employee benefit plan, contract or similar arrangement provided by the Company or an Affiliate unless expressly so provided by such other plan, contract or arrangement, or unless the Committee expressly determines that an Award or portion of an Award should be included to accurately reflect competitive compensation practices or to recognize that an Award has been made in lieu of a portion of competitive cash compensation.

25. Beneficiary Upon Participant's Death. To the extent that the transfer of a Participant's Award at his or her death is permitted under an Agreement, a Participant's Award shall be transferable at death to the estate or to the person who acquires the right to succeed to the Award by bequest or inheritance.

26. Requirements of Law.

(a) To the extent that federal laws do not otherwise control, the Plan and all determinations made and actions taken pursuant to the Plan shall be governed by the laws of the State of Minnesota without regard to its conflicts-of-law principles and shall be construed accordingly.

(b) If any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not effect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

EXHIBIT 13 X

The company succeeded in accelerating revenue and profitability growth over the past year. Our year-over-year revenue growth rate continues to accelerate, from 1.4 percent growth in 2003, climbing to an 8.1 percent growth rate in 2004, and now 12.6 percent in fiscal 2005. Earnings per diluted share for fiscal 2005 were $0.76, compared to $0.39 per diluted share in fiscal 2004. During 2005, Digi recorded a $5.7 million reversal of previously established tax reserves as a result of the settlement of a tax audit of prior fiscal years. Excluding the impact of the favorable tax settlement, Digi's earnings per diluted share would have been $0.51, or an increase of 30.8 percent over fiscal 2004.

A key to increased revenue growth is introducing new products that 'Make Device Networking Easy' for our customers. More precisely, it is our strategic intent to be the best in the world at commercial grade device networking. In laymen's terms, we provide products that connect things to networks. Not things in the home, but things in stores, factories, office buildings, banks, gas stations, oil rigs, hospitals, and many other vertical environments. That's why we call it commercial grade.

We provide hardware chips, modules, and boxes, with value-added software to provide the differentiated products that our customers desire. For example:

- - In self-checkout systems, Digi connects peripheral devices like scales, card readers and printers.

- - At intersections, Digi connects traffic signals so the flow of traffic can be more smoothly regulated.

- - On highways, Digi connects variable message signs, enabling authorities to post messages about congestion, stolen vehicles, or even abducted children.

- - In hospitals, Digi connects point-of-care testing devices, so tests can be done bedside with immediate results. Digi also networks ventilators, so doctors can remotely monitor and diagnose issues with a patient's breathing.

- - At power utilities, Digi networks meters to monitor power flow and avoid overload situations.

- - In factories, Digi networks machines controlling production lines for some of the nation's most popular consumer products.

The list is virtually endless. We believe that we are at the front end of a long-term growth trend to connect devices to networks in order to bring more intelligence to the device. Where the Internet was initially about connecting people via personal computers, the next phase of the Internet is about connecting devices.

Digi has dramatically changed its revenue mix over the past several years so that we have highly differentiated growth products that now make up a majority of our revenues. Our products and core technologies place us at the CENTER of this very exciting long-term growth opportunity. We introduced many exciting innovative products in fiscal 2005 that support our leadership position in device connectivity:

- - Early in the year Digi introduced the NS9360, an ARM 9-based chip that is a cost effective solution that integrates a high level of functionality and is ideal for customers in industrial automation, building automation, medical automation, instrumentation, networked displays, networked terminals, and industrial and point-of-sale printers.

- - The company introduced the ConnectCore(TM) family of core modules which are based on the NetSilicon(R) branded chips and optimized to provide quick time to market for our customers.

- - Digi also introduced the first in a series of data over cellular products with the launch of the Digi Connect(R) WAN for GSM and CDMA networks. We believe that Digi is bringing highly differentiated commercial grade products into this rapidly developing market opportunity. We have a very deep partnering relationship with Cingular for these products and are building relationships with Sprint, Verizon, Alltel and many of the other major wireless carriers worldwide.

- - The company introduced ConnectPort(TM) Display, the industry's first remote networking solution to utilize display, serial and USB Over IP(R) technology. ConnectPort Display is a network-enabled video display hub that allows standard video displays and other devices to be anywhere on a Local Area Network (LAN) or other Internet Protocol (IP) network without a locally attached host PC or thin client.

- - The company introduced the Rabbit(R) 4000 microprocessor, a chip that like its predecessors is designed specifically for embedded control, communications, and Ethernet connectivity but which also adds important new features. The new features will enhance the Rabbit core module offering and allow us to significantly broaden our core module customer base.

Digi ended the year with a cash and marketable securities balance of $50.2 million after spending $53.7 million on the acquisitions of Rabbit Semiconductor Inc. and FS Forth-Systeme GmbH and Sistemas Embebidos S.A. during fiscal 2005. The company once again ended the year with no bank debt. Our current ratio at year end was 4.4 to 1.

Acquisitions have been a key element of the Digi growth strategy over the past six years. We have leveraged acquisitions and organic development to augment our technology and product portfolio in the commercial grade device networking marketplace. In 2005 we executed two very important transactions with the acquisitions of Rabbit Semiconductor Inc. and FS Forth-Systeme GmbH/Sistemas Embebidos S.A. These acquisitions, coupled with the ConnectCore product family introduction, signified a major strategic push into the networked core module arena. The networked core module opportunity is an important element of our commercial grade device networking strategy because the modules that we offer to customers provide a networked platform with a core processor and lots of flexibility to allow them to add features and functionality. The primary value proposition for our device customers is that it allows them to get to market very quickly with a network-enabled device. We believe that this value proposition will gain momentum over time because the increasing number of device manufacturers that need to network their devices know very little about networking. We believe this will be a high growth market for Digi over the next several years and that Rabbit adds a significant brand to the Digi portfolio.

I would also like to take this opportunity to thank Mr. Mykola (Mike) Moroz, for his contributions to Digi since its inception in 1985. Mike was a founder of the company and has served as a member of the Board of Directors since July 1991. Mike will be retiring as a director and I would like to acknowledge him on behalf of the Board and the company for his many valued contributions over the years.

In summary, I am proud of the accomplishments of the Digi team in fiscal 2005. We took on significant challenges during the year and yet have managed to post very strong results. I look forward to continuing the positive momentum and having fun executing our strategies with the talented Digi team in fiscal 2006.

/s/ Joseph T. Dunsmore
- -----------------------
Joseph T. Dunsmore
Chairman, President and Chief Executive Officer

EXHIBIT 21

Subsidiaries of the Company

Digi International GmbH

Digi International (HK) Ltd.

Digi International Limited

Digi Services Limited

Digi International SARL

ITK International, Inc.

NetSilicon, Inc.

Rabbit Semiconductor Inc.

FS Forth-Systeme GmbH

Sistemas Embebidos S.A.

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-23857, 333-57869, 333-53366, 333-55488, 333-82674, 333-82678, 333-82668, 333-82670, 333-82672) of Digi International Inc. of our report dated November 28, 2005 relating to the financial statements and financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Minneapolis, Minnesota
December 6, 2005

EXHIBIT 24

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 28th day of November, 2005.

/s/ Kenneth E. Millard

Kenneth E. Millard

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 28th day of November, 2005.

/s/ Mykola Moroz

Mykola Moroz

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 28th day of November, 2005.

/s/ Guy C. Jackson

Guy C. Jackson

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 28th day of November, 2005.

/s/ William N. Priesmeyer

William N. Priesmeyer

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint Joseph T. Dunsmore and Subramanian Krishnan, and either of them, the undersigned's true and lawful attorneys-in-fact, with power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign and affix the undersigned's name as such director and/or officer of said Corporation to an Annual Report on Form 10-K or other applicable form, and all amendments thereto, to be filed by said Corporation with the Securities and Exchange Commission, Washington, D.C., under the Securities Act of 1934, as amended, with all exhibits thereto and other supporting documents, with said Commission, granting unto said attorneys-in-fact, and either of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 28th day of November, 2005.

/s/ Bradley J. Williams

Bradley J. Williams

EXHIBIT 31(a)

CERTIFICATIONS

I, Joseph T. Dunsmore, certify that:

1. I have reviewed this annual report on Form 10-K 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 we 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.

Date: December 7, 2005

/s/ Joseph T. Dunsmore

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

EXHIBIT 31(b)

CERTIFICATIONS

I, Subramanian Krishnan, certify that:

1. I have reviewed this annual report on Form 10-K 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 we 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.

Date: December 7, 2005

/s/ Subramanian Krishnan

Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer

Exhibit 32

CEO AND CFO CERTIFICATION OF PERIODIC REPORT

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, each of the undersigned certifies that:

(1) the Annual Report on Form 10-K of the Company for the year ended September 30, 2005 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joseph T. Dunsmore

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

/s/ Subramanian Krishnan

Subramanian Krishnan
Senior Vice President, Chief Financial Officer and Treasurer

FAEGRE & BENSON LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, Minnesota 55402
612-766-7769

December 7, 2005

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Digi International Inc.
Annual Report on Form 10-K for
the year ended September 30, 2005
File No. 0-17972

Ladies and Gentlemen:

On behalf of Digi International Inc. (the "Company"), there is hereby transmitted for filing, pursuant to the Electronic Data Gathering, Analysis and Retrieval System, the Company's Annual Report on Form 10-K for the year ended September 30, 2005. No fee is required for this filing.

Other than the adoption of FAS 142 effective October 1, 2002 (as discussed in Note 4 to the consolidated financial statements), there was no change from the preceding year in any accounting principles or practices or in the method of applying any such principles or practices.

Very truly yours,

Amy C. Seidel

Enclosures
cc: Kris Krishnan
Brenda Mueller
James E. Nicholson