UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended: September 30, 1999

OR

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

For the transition period from ____ to ____.

Commission file number: 0-17972

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

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

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

(612) 912-3444
(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, $.01 PAR VALUE
(Title of each class)

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

Yes X   No
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of voting stock held by nonaffiliates of the Registrant, based on a closing price of $10.94 per share as reported on the National Association of Securities Dealers Automated Quotation System-National Market System on December 17, 1999 was $147,485,017.

Shares of common stock outstanding as of December 10, 1999: 15,008,190.

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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, 1999 and Proxy Statement for the Registrant's Annual Meeting of Stockholders scheduled for January 26, 2000, a definitive copy of which will be filed on or about December 31, 1999. 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.

PART I

ITEM 1. BUSINESS

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 Company is a worldwide provider of communications adapters that enable open systems, server-based applications. In addition, the Company produces local area networking (LAN) products.

The Company operates exclusively in a single business segment and sells its products through a global network of distributors, systems integrators, value added resellers (VARs) and original equipment manufacturers (OEMs). The Company also sells direct to select accounts and the government.

Digi International Inc. is traded on the Nasdaq National Market under the symbol DGII. The Company has its worldwide headquarters in Minnetonka, Minnesota, with regional and sales offices throughout the U.S. and worldwide, including Germany, Paris, London, Amsterdam, Copenhagen, Singapore, Hong Kong, Sydney, and Tokyo.

PRODUCTS

Digi products enable a virtually unlimited number of users to be connected locally or remotely to a LAN, the Internet or to multi-user computer systems. The Company's products provide asynchronous and synchronous data transmissions for analog modems, ISDN (Integrated Services Digital Network), X.25, Frame Relay or T1/E1 connections. The application markets where these products are most prominently used are POS (Point-of-Sales Systems), Industrial Automation, routing, remote access, and network fax.

The Company's two primary communication adapter product lines are its DataFire digital and AccelePort multi-port serial communications adapters. These adapters integrate unique and powerful (Digital Signal Processing) DSP-based technology that allows them to support a broad array of communications functions simultaneously. It collaborates with partners to ensure that its boards are among the industry's most widely supported. This includes working closely with leading makers of PCs, workstations and other computer hardware, to offer the highest levels of compatibility. The Company also conforms to the standards necessary to enable built-in support for its products in many major operating systems, and writes its own drivers to expand that support where necessary. The Company also works closely with software application partners, to pre-test and certify their applications to run on Digi boards.

The Company's server-based communication adapter products constituted approximately 90%, 80% and 76% of net sales in fiscal 1999, 1998 and 1997, respectively.

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

ITEM 1. BUSINESS (CONTINUED)

SERVER-BASED COMMUNICATIONS AND THE MARKET

Server-based communications is based on a open systems where the PC server and operating system serve as standardized components. The components of a server-based communications solution include:

A computer hardware platform and operating system, such as a PC or RISC server running Windows NT, Novell NetWare, UNIX, LINUX or an IBM AS/400 midrange computer;

One or more communications adapters, like Digi's DataFire and AccelePort products;

Specialized communications application software, available from a wide range of companies.

Server-based communications solutions are a major growth area. As the middleware functions of operating systems are improved and enhanced, the Company believes this market will expand dramatically over the next few years. It has already begun to grow from something more suitable for small- to medium-sized businesses to technology with the reliability, performance and scalability to meet the needs of large enterprises. The Company believes that in the future, server-based solutions will continue to grow market share against proprietary boxes for remote access, network fax, and, computer telephony

The Company believes that the key benefits for server-based solutions include low cost of ownership, increased flexibility and scalability, dependability, simplified training and support, and the ability for channel partners to add value and increase profits.

VOICE OVER INTERNET PROTOCOL

The Company entered the Internet telephony market with the acquisition of ITK International, Inc. ("ITK International" or "ITK") in July of 1998 and its Voice over Internet Protocol ("VoIP") technology. ITK provides VoIP technology with the NetBlazer 8500 gateway, a "proof of concept" product that converts voice signals to TCP/IP packets and routes them over IP networks such as the Internet and company Intranets. This capability combines voice and data onto one cost-effective network. Although the VoIP technology acquired from ITK continues to be under development, the Company believes that this technology will be successful once a functioning finished product is complete and can be marketed to "Carrier Class" telephone companies. The current version of the NetBlazer 8500, which includes a sub-set of its ultimate feature set, provided revenues of $3.0 million during fiscal 1999; total fiscal 1999 net revenue for ITK was $25.7 million. Digi acquired ITK International for approximately $29.6 million in cash, stock, replacement stock options and the assumption of $39.8 million of liabilities and restructuring/integration costs.

UNIVERSAL SERIAL BUS AND TERMINAL SERVER

The Company expanded its product lines with its acquisition of Central Data Corporation ("Central Data" or "CDC") in July 1998. The Company also acquired in-process research and development from Central Data related to Universal Serial Bus (USB) technology. This in-process technology will give customers the ability to maintain existing non-USB peripheral equipment and connect with new PCs, which contain advanced USB interfaces. The Company introduced USB products in fiscal 1999, which provided $266,000 of net revenue; total net revenue contributed by CDC product lines during fiscal 1999 was $16.9 million. The EtherLite product line, a family of terminal servers used in multiuser and communications applications, provided 70% of these net revenues. The Company acquired Central Data for approximately $21.3 million in cash, stock, replacement stock options and the assumption of $4.4 million of liabilities and restructuring/integration costs.

ITEM 1. BUSINESS (CONTINUED)

DISTRIBUTION AND PARTNERSHIPS

The Company sells and markets its products through a global network of distributors, systems integrators, value added resellers (VARs) and original equipment manufacturers (OEMs). The Company also sells direct to select accounts and the government. Internationally, Digi sells and markets its products through 180 distributors in more than 65 countries. More than 300 VARs participate in the DigiVAR Program.

U.S. distributors include: Ameriquest/Robec, Access Graphics, Anixter, Avnet/Hallmark, Gates/Arrow Distributing, Graybar, Ingram Micro, Jones Business Systems, Kent, Merisel, Pinacor, Tech Data Corporation, Westcon and Savior Technologies. Canadian distributors include Gates/Arrow Electronics, EMJ Data Systems, Ingram Micro Canada, Merisel Canada and Tech Data Canada.

European distributors include Miel, Arecta, International Computer Products, Connect Service Riedlbauer, Mitrol, Euroline and Data Solutions. Latin American and Asia Pacific distributors include Tech Pacific, Sumisho Datacom, Lantech, Sealcorp Computer Products, Ingram Dicom and Unisel.

Digi maintains strategic partnerships with other industry leaders to develop and market technology solutions. These include most major communications software vendors, operating system suppliers and computer hardware manufacturers.

Key Company partners include: Citrix Systems, Compaq, Hewlett-Packard, IBM, Intel, Lotus, Micron, Microsoft, Motorola, Novell, Red Hat, Santa Cruz Operation (SCO), Sun Microsystems, and Fundacao CPqD (the Brazilian R&D Center for Telecommunications).

CUSTOMERS

The Company's customer base includes many of the world's largest companies. IBM made the Company's adapter boards the first integrated communications offering for the AS/400 in 1999. Red Hat has made the Company a development partner. The Company has OEM relationships with leading vendors, allowing them to ship the Company's boards with their systems. These vendors include NCR, Sun Microsystems, Silicon Graphics, AT&T, Siemens and many others. Many of the world's leading telecommunications companies and ISPs also rely on the Company's products.

During the year ended September 30, 1999, two customers comprised more than 10% of net sales each: Tech Data at 15.4% and Ingram Micro at 13.4%. During the year ended September 30, 1998, two customers comprised more than 10% of net sales each: Ingram Micro at 15.5% and Tech Data at 13.7%. During the year ended September 30, 1997, two customers comprised more than 10% of net sales each: Ingram Micro at 15.1%, and Tech Data at 10.5%.

COMPETITIVE CONDITIONS

The computer industry is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. The Company competes for customers on the basis of product performance in relation to compatibility, support, quality and reliability, product development capabilities, price and availability. The Company believes that it is the market leader in serial port boards for server-based communications in the computer industry. With respect to the LAN business, the Company believes it commands less than a 5% market share. The Company is currently establishing its position in the remote access market for the Company's DSP-based RAS product lines. The Company will enter the Internet telephony market upon full development of its VoIP technology.

ITEM 1. BUSINESS (CONTINUED)

Many of the Company's competitors and potential competitors 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 and 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 major competition for open system server-based communications solutions offered by the Company are proprietary boxes from companies like Cisco, Ascend, 3Com, Shiva and others. Today, these proprietary boxes represent the majority of the market for networked communications solutions.

AETHERWORKS CORPORATION

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

OPERATIONS

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

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

During fiscal years 1997, 1998 and 1999, the Company's research and development expenditures were $18.0, $17.0, and $24.7 million, respectively.

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

As of September 30, 1999, the Company had backlog orders which management believed to be firm in the amount of $5.0 million. All of these orders are expected to be filled in the current fiscal year. Backlog as of September 30, 1998 was $2.9 million.

Total employees at September 30, 1999 were 583.

ITEM 2. PROPERTIES

The Company's headquarters and research facilities are located in a 130,000 square foot office building in Minnetonka, Minnesota which the Company acquired in August 1995 and has occupied since March 1996. The Company's primary manufacturing facility is located in a 58,000 square foot building in Eden Prairie, Minnesota, which the Company purchased in May 1993 and has occupied since August 1993. Additional office and research facilities include a 63,000 square foot facility in Dortmund, Germany, a 46,170 square foot facility in Sunnyvale, California, the lease for which expires in April 2002, and a 5,000 square foot facility in Champaign, Illinois, the lease for which expires in January 2002.

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

ITEM 3. LEGAL PROCEEDINGS

Between January 3, 1997 and March 7, 1997, the Company and certain of its previous officers were named as defendants in putative securities class action lawsuits filed in the United States District Court for the District of Minnesota by 21 lead plaintiffs on behalf of an alleged class of purchasers of the Company's common stock during the period January 25, 1996 through December 23, 1996. The putative class actions were thereafter consolidated (Master File No. 97-5 DWF/RLE). The Consolidated Amended Class Action Complaint ("Consolidated Amended Complaint") alleges that the Company and certain of its previous officers violated the federal securities laws by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results.

On February 25, 1997, the Company and certain of its previous officers also were named as defendants in a securities lawsuit filed in the United States District Court for the District of Minnesota by the Louisiana State Employees Retirement System (Civil File No. 97-440, Master File No. 97-5 DWF/RLE) (the "Louisiana Amended Complaint"). The Louisiana Amended Complaint alleges that the Company and certain of its previous officers violated the federal securities laws and state common law by, among other things, misrepresenting and/or omitting material information concerning the Company's operations and financial results.

In a decision issued on May 22, 1998, the Court dismissed without leave to replead all claims asserted in both cases, except for certain federal securities law claims based upon alleged misrepresentations and/or omissions relating to the accounting treatment applied to the Company's AetherWorks investment. The Court also limited the claims asserted in the Louisiana Amended Complaint to the 11,000 shares of the Company's stock held subsequent to November 14, 1996, for which the Louisiana Amended Complaint claims damages of $184,276.40 and seeks an award of attorneys' fees, disbursements and costs. The Consolidated Amended Complaint seeks compensatory damages of approximately $43.1 million plus interest against all defendants, jointly and severally, and an award of attorneys' fees, experts' fees and costs. The claims in the two actions remain pending against the Company and its former officers Ervin F. Kamm, Jr. and Gerald A. Wall.

The 21 lead plaintiffs have moved for class certification with respect to the claims asserted in the Consolidated Amended Complaint. The Company and its former officers intend to oppose the motion. No date has been set for a hearing on the class certification motion. With the possible exception of additional depositions of certain lead plaintiffs, discovery in all of the actions has been completed.

ITEM 3. LEGAL PROCEEDINGS (CONTINUED)

The Company and its former officers served motions for summary judgment in all actions on November 19, 1999. Briefing on the motions is scheduled to be completed by February 4, 2000, and a hearing is expected to be held before the Court after that date.

The ultimate outcomes of these actions cannot be determined at this time, and no potential assessment of their effect, if any, on the Company's financial position, liquidity or future operations can be made.

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

There were no matters submitted to the vote of security holders during the quarter ended September 30, 1999.

PART II

ITEM 6. SELECTED FINANCIAL DATA

	1999	1998 (As restated (1))	1997	1996	1995
Net sales	$ 193,506	$ 182,932	$ 165,598	$ 193,151	$ 164,978
Percentage increase (decrease)	5.8%	10.5%	(14.3)%	17.1%	26.0%
Net income (loss)	3,192	(71)	(15,791)	9,300	19,331
Percentage increase (decrease)	4,589.5%	99.6%	(269.8)%	(51.9)%	15.7%
Net income (loss) per share-basic	0.22	(0.01)	(1.18)	0.70	1.42
Percentage increase (decrease)	2,300.0%	99.2%	(268.6)%	(50.7)%	(21.4)%
Net income (loss) per share--assuming dilution	0.22	(0.01)	(1.18)	0.68	1.39
Percentage increase (decrease)	2,300.0%	99.2%	(268.6)%	(51.1)%	19.8%
Total assets	176,330	191,521	118,311	129,939	126,043
Percentage (decrease) increase	(7.9)%	61.9%	(8.9)%	3.1%	22.7%
Long-term debt	9,206	11,124			
Percentage (decrease)	(17.2)%				
Stockholders' equity	127,164	121,251	95,471	109,943	105,827
Percentage increase (decrease)	4.9%	27.0%	(13.2)%	3.9%	16.1%

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS AND PERCENTAGES)

(1) See Note 2 to the Company's consolidated financial statements

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," "expect," "anticipate," "intend," "estimate," "target," "may," "will," "plan," "project," "should," "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, the following: (i) the highly competitive market in which the Company operates; (ii) the Company's ability to respond to rapidly developing changes in its marketplace; (iii) delays in the Company's product development efforts; (iv) the useful life of products once developed; (v) the Company's ability to integrate its recent acquisitions and to develop marketable products from the acquired in-process research and development; (vi) the Company's reliance on distributors; (vii) declining prices of networking products; (viii) uncertainty in consumer acceptance of the Company's products; and (ix) changes in the company's level of revenue or profitability. These and other risks, uncertainties and assumptions identified from time to time in the Company's filings with the Securities Exchange Commission, including without limitation, its annual report on Form 10-K and its quarterly report on Form 10-Q, 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.

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

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

	1999	1998(1)	1997	1999 over 1998	1998 over 1997
Net sales	100.0 %	100.0 %	100.0 %	5.8 %	10.5 %
Cost of sales	49.3	48.4	51.6	7.7	3.6
Gross margin	50.7	51.6	48.4	4.0	17.8
Operating expenses:					
Sales and marketing	21.2	20.4	22.1	10.0	1.7
Research and development	12.8	9.3	10.9	45.5	(5.6)
General and administrative	12.2	9.3	11.7	39.1	(12.0)
Acquired in-process research and development	-	8.8	-	(100.0)	-
Restructuring	0.3	0.5	6.3	(40.5)	(90.3)
	46.5	48.3	51.0	1.8	4.6
Operating income (loss)	4.2	3.3	(2.6)	36.2	239.6
Other (expense) income, net	(0.1)	1.0	0.1	(114.1)	1,082.2
AetherWorks Corporation net operating loss	-	-	(3.5)	-	(100.0)
AetherWorks Corporation gain (write-off)	-	0.7	(3.5)	(100.0)	(123.4)
Income (loss) before income taxes	4.1	5.0	(9.5)	(13.4)	158.7
Provision for income taxes	2.5	5.0	0.1	(48.4)	10,031.0
Net income (loss)	1.6 %	0.0 %	(9.6)%	4,589.5 %	(99.6) %

(1) See Note 2 to the Company's consolidated financial statements

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

RESTATEMENT

The Company revised the accounting treatment of its July 1998 acquisitions of ITK and CDC in response to comments received from the Securities and Exchange Commission. On August 16, 1999, the Company filed Amendment No. 1 to the Registrant's 1998 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the purpose of restating its financial statements for the year ended September 30, 1998.

NET SALES

The $10.6 million or 5.8% increase in net sales from 1998 to 1999 and the $17.3 million or 10.4% increase in net sales from 1997 to 1998 occurred within the Company's principal product groups as follows:

	Percent of Annual Net Sales			Annual Sales Increase (Decrease)	
	1999	1998	1997	1999	1998
Server Based	89.8%	79.8%	75.7%	18.9%	16.6%
Physical Layer	10.2%	20.1%	23.9%	(46.2)%	(6.9)%
Other	0.0%	0.0%	0.4%	0.0%	(100.0)%

Sales of ISDN and VoIP products added in connection with the July 1998 acquisition of ITK and USB and Etherlite products added in connection with the July 1998 acquisitions of CDC generated $42.5 million of net sales for the 1999 fiscal year, an increase of $32.8 over the net sales recognized during of the year ago period, which included ITK and CDC revenue in the fourth quarter of the fiscal year. These revenue increases were mitigated by a revenue decrease of $13.3 million for the Company's legacy asynchronous products due to shrinking of the overall market and a shift in demand to digital technology products. The Company also experienced a decrease in demand for the Company's physical layer products due to a decrease in prices and competition resulting in a decrease in revenues of $17.0 million. Net sales of the Company's new DSP RAS products were $8.7 million for the 1999 fiscal year, adding $8.1 million over total DSP RAS product revenue in fiscal 1998. Net sales in fiscal 1998 increased from fiscal 1997 largely because the Company reduced inventory levels in the North American distribution channel throughout 1997 and into the first quarter of fiscal 1998. This resulted in a net increase in sales within the distribution channel during the remainder of 1998.

Net sales to original equipment manufacturers (OEMs) increased 18.6% over 1998 and as a percentage of total net sales, increased to 24.9% versus 22.2% in 1998. The increase was principally a function of sales added by ITK. Net sales to OEMs for 1997 were 23.5% of total sales.

Net sales into the distribution channel increased 5.9% over 1998 and as a percentage of total net sales, remained unchanged at 69.3% in 1999, compared to 1998. International distribution net sales increased by 31.4% over fiscal 1998 primarily due to new product revenues and the expanded distribution channel added by ITK. Domestic distribution net sales declined by 6.6% due to a decrease in inventory levels in the distribution channel. Net sales to the distribution market for 1997 represented 64.1% of total net sales.

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

NET SALES (CONTINUED)

During fiscal years 1999, 1998 and 1997, the Company's net sales to customers outside the United States, primarily in Europe, were approximately $67.4 million, $46.7 million and $44.5 million, respectively, comprising approximately 34.8%, 25.5% and 26.9% of total net sales.

GROSS MARGIN

Gross margin in 1999 decreased to 50.7%, compared to 51.6% in 1998, primarily due to the negative impact of sales of lower gross margin ITK products, an increased percentage of lower margin OEM sales, market-driven erosion of gross margin on physical layer products, and increases in the Company's inventory valuation reserves. Gross margin in the fourth quarter of fiscal 1999 improved to 54.0% when compared to gross margin of 52.0% in the fourth quarter of fiscal 1998, primarily due to improved operating efficiencies in the Company's production facilities.

Gross margin in 1998 rose to 51.6% compared to 48.4% in 1997 due to cost control measures and favorable product sales mix. Gross margin also benefited as net sales of historically lower-margin OEM and physical layer products declined as a percentage of total net sales. Offsetting the favorable sales mix were increases in inventory valuation reserves, sales discounts granted, and a higher proportion of lower margin products sold in the fourth quarter of fiscal 1998 due to the acquisition of CDC and ITK.

OPERATING EXPENSES

Excluding acquired in-process research and development charges of $16,064,933 recorded in 1998, operating expenses in 1999 increased 24.5% from 1998. Sales and marketing expenses increased by $3.7 million due to $5.6 million of expenses added by ITK and CDC, $1.8 million expended to promote new DSP RAS products, and a $3.7 million cost decline primarily due to reduced North American channel marketing efforts. Research and development expenses increased $7.7 million due to $4.1 million of additional costs added by ITK and CDC with the remaining increase of $3.6 million due to new product development costs for the DSP RAS products. General and administrative expenses increased by $6.6 million primarily due to increased amortization of acquisition-related goodwill and other identifiable intangibles of $8.0 million offset by $1.4 million of cost reductions related reduced information systems implementation costs and other cost-saving initiatives.

Operating expenses in 1998 declined 3.7% from 1997, excluding acquired in-process research and development charges of $16,064,933 recorded in 1998 and the restructuring charges recorded in 1998 and 1997 of $1,020,000 and $10,471,482 respectively. The operating expense decline reflected reductions in the workforce, decreased marketing costs and cost savings achieved through the consolidation of U.S. research and development efforts, offset by CDC and ITK operating expenses of $3.8 million. General and administrative expenses declined in 1998 due to workforce reductions and cost-saving initiatives, offset by increased intangible asset amortization.

The $1.2 million of net restructuring charges recorded in fiscal 1999 were associated with the board approved plan to reorganize the sales and marketing functions in Germany, England and the United States, by consolidating worldwide sales and marketing resources into strategic locations. The charges

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

OPERATING EXPENSES (CONTINUED)

consist principally of existing commitments for rent on facilities vacated by the Company and termination payments associated with the elimination of 42 positions. These activities are expected to be completed by December 1999. The Company anticipates annual cost savings of $1.3 million from these restructurings. (See Note 4 to the Company's consolidated financial statements).

The $1,020,000 restructuring charge recorded in the fiscal 1998 fourth quarter was associated with a board-approved plan to consolidate existing offices in Germany with those acquired from ITK. The charge consists principally of rent, contractual payments on office equipment, write-offs of leasehold improvements and termination costs associated with the elimination of six positions. Activities were completed by June 30, 1999. After change in estimate adjustments of $572,000, the net charge of $448,000 is anticipated to yield annual cost savings of $425,000. (See Note 4 to the Company's consolidated financial statements).

The $10,471,482 restructuring charge recorded in the fiscal 1997 second quarter was related to a board-approved plan to consolidate operations and reduce costs and expenses. The restructuring charge consisted of $1,259,769 in net cash expenditures (primarily employee termination costs), all of which had been paid as of September 30, 1997, and $9,211,713 resulting from the write-down of asset carrying values. (See Note 4 to the Company's consolidated financial statements).

OTHER DEVELOPMENTS

On December 16, 1999, the Company announced that it expects revenue for the fiscal 2000 first quarter ending December 31, 1999 to be in a range of $39 million to $41 million and earnings per diluted share to be in a range of $0.03 to $0.07. The Company attributes the lower than expected revenues and earnings for the first quarter primarily to two factors associated with Year 2000 concerns. Sales to the Company's OEM customers have been affected by a temporary change in the purchasing patterns of end users until after January 2000. Sales into the Company's distribution channel have been impacted similarly by end-user purchasing behavior and also more significantly by inventory reductions as channel participants reduce levels due to Year 2000 concerns.

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

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT

ACQUISITION OF ITK INTERNATIONAL, INC.:

In July 1998, the Company acquired all of the outstanding common stock of ITK. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $3,484,000. (See Note 4 to the Company's consolidated financial statements).

At the time of the Company's acquisition, ITK described itself as a Remote Access Server (RAS) product company. Although ITK did offer its own line of ISDN cards and networking boards, the Company's acquisition was made principally to acquire the voice over Internet Protocol (VoIP) technology under development by ITK. This VoIP technology, if successfully developed, would allow users to send packetized voice signals through the Internet. The Company believes that the VoIP technology under development at the time of the acquisition could provide for the development of products which would be a natural extension of the Company's current product offerings and could position the Company to address substantially larger markets than the markets served by the Company's current products.

At the time of the acquisition, ITK had developed a proof of concept prototype product ("NetBlazer 8500") which demonstrated that the method of voice and data compression under development by ITK and the method of combining VoIP and remote access functionality under development by ITK had the potential to be further developed into a product marketable to "Carrier Class" telephone companies. However, the NetBlazer 8500 required further development before it could meet the technical and functional requirements of such customers. Accordingly, the Company is uncertain whether the VoIP technology being developed will ultimately meet the technical requirements of Carrier Class telephony customers or whether it will be commercially viable.

As of the date of the acquisition, the nature of the development efforts related to the purchased, in-process research and development projects, as well as the efforts required to complete development of those projects into commercially viable products, included development projects to address the following: (a) development of enhanced technical attributes, including enhanced port density, redundancy, network management capabilities, a higher fault tolerance, compliance with telephone industry standards such as "SS7" and "NEBS" compliancy; (b) development of significant hardware and software functions considered integral to a product with broad appeal to end users and the telephone companies, including computer-to-phone capabilities, interoperability with other vendor's gateways, one-stage dialing , local tone simulation and announcements, end-to-end transparent disconnect cause delivery and real-time FAX-over capabilities, among others; and (c) re-engineering of the prototype design to permit cost effective manufacture and commercial use, including migration from a UNIX operating system to a Windows NT operating system.

It is not certain that development efforts on these projects will allow for Carrier Class telephone company and end-user specifications to be met. Failure to achieve these specifications or to achieve market viability will cause the VoIP projects to fail. If these products are not successfully developed, the sales and profitability of the Company may be adversely affected in future periods. Additionally, the value of other identifiable intangible assets and goodwill acquired may become impaired.

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

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

ACQUISITION OF ITK INTERNATIONAL, INC.: (CONTINUED)

Management estimates that $11.3 million of the purchase price represents the fair value of purchased in-process research and development related to the VoIP projects referred to above, that had not yet reached technological feasibility and had no alternative future uses. These amounts were expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the alternative income valuation approach to determine the estimated fair value of the purchased in-process research and development. This estimate is based on the following assumptions:

- The estimated revenues are based upon projected average annual revenue growth rates from future products expected to be derived once technological feasibility is achieved of between 18% and 65% during the period from 2000 through 2005, starting with an estimated growth rate of 65% from 2000 to 2001 with steadily declining rates of estimated revenue growth through 2005. Estimated total revenues expected from products to be developed using purchased in-process research and development peak in the year 2005 and decline rapidly in 2006 and 2007 as other new products are expected to enter the market. These projections are based on estimates made by the Company's management of market size and growth (which are supported by independent market data), expected trends in technology and the nature and expected timing of new product introductions by ITK and its competitors.

- The estimated costs of sales are based upon the historical, stand-alone costs of ITK without considering any synergies due to the acquisition by the Company.

- The estimated selling, general and administrative expenses of between 37% and 32% of revenues from 2000 through 2003 and between 29% and 27% of revenues between 2004 and 2007, are based upon the estimated expense levels of ITK as derived from the historical, stand-alone costs of ITK without considering any synergies due to the acquisition by the Company.

- The discount rate utilized in the alternative income valuation approach is based on the weighted average cost of capital (WACC). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The WACC estimated by an independent third-party appraiser for the Company, as a corporate business enterprise is 14%. The discount rate used in the alternative valuation approach was 30%. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including uncertainty surrounding the successful development of purchased research and development, the estimated useful life of such completed research and development, the profitability levels of such completed research and development and the uncertainty of technological advances that are unknown at this time.

The Company estimated that the purchased in-process research and development related to VoIP was 83% complete as of the acquisition date. This estimate was based upon research and development costs

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

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

ACQUISITION OF ITK INTERNATIONAL, INC.: (CONTINUED)

incurred to date compared to total estimated development costs. As of the date of acquisition, the estimated cost to complete the VoIP to a point of technological feasibility was approximately $2.3 million, expected to be incurred over a period of approximately 20 months following the acquisition. This estimate is 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 identifiable intangible assets of $21,100,000 included in the purchase price allocation set forth above are comprised of proven technology with an estimated fair value of $19,700,000 and an assembled workforce with an estimated fair value of $1,400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill of $17,727,086, which is being amortized over seven years. With regard to the proven technology, the Company intends to further enhance the strengths of this product range and implement a plan to gain leadership in the ISDN market. The Company's core asset is the comprehensive set of common application programming interface (CAPI) and CAPI-enhancing features combined with highly intelligent ISDN protocol implementation which provide for integration into server-based communication solutions for the media communication market.

The Company is continuing development of the acquired in-process VoIP technology and, as of September 30, 1999, believes that its development efforts are on schedule to meet the product release schedule referred to above with potential increases in its research and development costs. However, these expectations are subject to change, given the uncertainties of the development process and changes in market expectations. Development costs incurred were $1.9 million during the year ended September 30, 1999. The current version of the NetBlazer 8500, which includes a sub-set of the ultimate feature set, provided revenues of $3.0 million during fiscal 1999.

ACQUISITION OF CENTRAL DATA CORPORATION:

In July 1998, the Company acquired all of the outstanding common stock of CDC. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $750,000. (See Note 4 to the Company's consolidated financial statements).

Although CDC did offer its own line of traditional serial port connectivity products, the Company's acquisition was made principally to acquire the Universal Serial Bus (USB) technology under development by CDC. This USB technology, if successfully developed, would broaden the Company's product offerings to include this new, emerging industry-standard port technology. Management considers such a product offering integral to its future market share because the marketplace is migrating from the traditional serial I/O (input/output) technology (in which the Company has significant market share) to USB technology. The Company also believes that it can reduce its time to market by 12 to 18

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

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

ACQUISITION OF CENTRAL DATA CORPORATION: (CONTINUED)

months by acquiring CDC's in-process research and development rather than initiating development of its own USB technology.

At the time of acquisition, CDC had developed a prototype of both the 2-port and 4-port USB connectivity technologies that demonstrated the validity of CDC's product development plan. However, the USB technology development was still in process, and required significant development work and field testing before it could meet the technical and functional requirements of customers and achieve commercial viability. Accordingly, the Company was uncertain whether the technology being developed could ultimately meet the technical and economic requirements of the marketplace and become commercially viable.

As of the date of the acquisition, the nature of the development efforts related to the purchased, in-process research and development projects, as well as the efforts required to complete development of those projects into commercially viable products included: (a) development of new hardware designs and software engineering relating to a complete reengineering of the in-process USB technology; (b) development of new hardware designs for 8-port USB products; and (c) development of a new "hub" architecture to support the CDC USB technology.

It is not certain that development efforts on these projects will allow for user specifications to be met or commercial viability to be achieved. Failure to achieve these specifications or to achieve market viability will cause the USB projects to fail. If these products are not successfully developed, the sales and profitability of the Company may be adversely affected in future periods. Additionally, the value of other identifiable intangible assets and goodwill acquired may become impaired.

Management estimates that $4.7 million of the purchase price represents the fair value of purchased in-process research and development related to the USB projects referred to above, that had not yet reached technological feasibility and had no alternative future uses. These amounts were expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition.

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

- The estimated revenues are based upon projected average annual revenue growth rates form future products expected to be derived once technological feasibility is achieved of between 9% and 52% during the period from 1999 through 2002, starting with an estimated growth rate of 52% from 1999 to 2000 with a declining rate of estimated revenue growth through 2002. Estimated total revenues expected from products to be developed using purchased in-process research and development peak in the year 2002 and decline rapidly in 2003 and 2004 as other new products are expected to enter the market. These projections are based on estimates made by the Company's management of market size and growth (which are supported by independent market data), expected trends in technology and the nature and expected timing of new product introductions by CDC and its competitors.

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

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

ACQUISITION OF CENTRAL DATA CORPORATION: (CONTINUED)

- The estimated costs of sales are based upon the historical, stand-alone costs of CDC without considering any synergies due to the acquisition by the Company.

- The estimated selling, general and administrative expenses of between 35% and 30% of revenues from 1999 to 2003 and 27% of revenues in 2004, are based upon the estimated expense levels of CDC as derived from the historical, stand-alone costs of CDC without considering any synergies due to the acquisition by the Company.

- The discount rate utilized in the alternative income valuation approach is based on the weighted average cost of capital (WACC). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The WACC estimated by an independent third-party appraiser for the Company, as a corporate business enterprise, is 14%. The discount rate used in the alternative valuation approach was 30%. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including uncertainty surrounding the successful development of purchased research and development, the estimated useful life of such completed research and development, the profitability levels of such completed research and development and the uncertainty of technological advances that are unknown at this time.

The Company estimated that the purchased in-process research and development related to USB was 87% complete as of the acquisition date. This estimate was based upon research and development costs incurred to date compared to total estimated development costs. As of the date of acquisition, the estimated cost to complete the USB technology to a point of technological feasibility was approximately $600,000, expected to be incurred over a period of approximately nine months following the acquisition. This estimate is 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 identifiable intangible assets of $9,800,000 included in the purchase price allocation set forth above are comprised of proven technology with an estimated fair value of $9,400,000, and an assembled workforce with an estimated fair value of $400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill in the amount of $9,711,298, which is being amortized over seven years.

The Company has developed the acquired in-process USB research and development and released USB products, with initial product revenues generated during November 1998. Included in revenues for fiscal 1999 is approximately $266,000 of revenues from the first release of certain USB products. Actual revenues are below original projections due to delays in the release and marketing of certain USB products. Research and development expenditures incurred to advance the acquired in-process USB technology were $500,000 for fiscal 1999.

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

OTHER (EXPENSE) INCOME

Other expense of $256,000 in 1999 consisted of $1,015,000 of interest expense on lines of credit and long term debt, $856,000 of interest income on short term investments, and $97,000 of miscellaneous other expense. Other income for 1998 included primarily interest income on cash equivalents and a fiscal 1998 third-quarter reversal of a $1.4 million previously accrued obligation related to lease guarantees for AetherWorks Corporation. As discussed in the next item below, the obligation is no longer required because the Company is no longer the primary guarantor for these leases.

AETHERWORKS CORPORATION
NET LOSS AND WRITE-OFF

In connection with the Company's previously purchased $13.8 million of convertible notes from AetherWorks Corporation, in May 1998 the Company exchanged such notes for a non-interest bearing $8.0 million non-convertible note and was released from all of its guarantees of certain lease obligations of AetherWorks. Due to significant uncertainty as to its collectibility, the $8.0 million note, which matures in 2001, has been recorded by the Company as having no carrying value. In fiscal 1997 the Company used the equity method to account for its investment in AetherWorks and record a net loss of $5.8 million, which represented 100% of AetherWorks' loss for the year. The percentage of AetherWorks' net losses included in the Company's financial statements was based upon the percentage of financial support provided by the Company (versus other investors) during 1997. The Company wrote off its investment in AetherWorks as of September 30, 1997, and recorded a $5.8 million charge, composed of its $2.4 million remaining investment, its $2.0 million remaining obligation to purchase additional notes and $1.4 million for the obligation to guarantee certain AetherWorks leases. The Company no longer has any funding obligations or any potential equity interest in or management control over AetherWorks. Consequently, the Company has not included any of AetherWorks' net losses in its results of operations during fiscal 1999 and fiscal 1998.

INCOME TAXES

The Company recorded a $4.8 million tax provision for 1999 and $9.3 million tax provision for 1998. These tax provision amounts were required primarily because of the write-off of acquired in-process research and development and because the amortization of certain identifiable intangible assets and goodwill acquired in the purchase of ITK and CDC is not deductible for income tax reporting purposes. In 1997, the Company recorded a $0.1 million tax provision, while reporting a pre-tax loss for that year. That provision was necessary due to the non-deductibility of certain intangible assets written off as part of the restructuring charge, the AetherWorks net losses and the related investment write-off.

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

INFLATION

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

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations, and, in prior years, with proceeds from earlier public offerings.

The Company's working capital increased from $37.9 million at September 30, 1998, to $59.9 million at September 30, 1999. The Company maintains lines of credit with various financial institutions providing for borrowings of up to $15.9 million, depending upon levels of eligible accounts receivable and inventories. As of September 30, 1999, $4.8 million had been borrowed under these line of credit agreements.

During 1999, the Company increased cash balances by approximately $10.6 million, through cash flow from operations, principally due to an increase in cash generated from operations.

Investing activities consisted of net investments of $13.7 in marketable securities and purchases of $4.8 million of equipment, capital improvements, and expansion of the Company's enterprise-wide Enterprise Resource Planning (ERP) software system into locations outside of the Minnetonka headquarters.

Financing activities consisted of payments on line of credit and debt obligations totaling $5.9 million and $815,000 for repurchase of shares of the Company's common stock, which was offset by $3.0 million received from the exercise of employee stock options and employee stock purchase plan transactions.

In September 1998, the Board of Directors authorized a program to repurchase up to one million shares of the Company's common stock for use in the Company's benefit plans. As of September 30, 1999, 120,000 shares had been repurchased under this program at a weighted average price of $8.03.

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

FOREIGN CURRENCY TRANSLATION

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

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

FOREIGN CURRENCY TRANSLATION (CONTINUED)

During 1999, the Company had approximately $67.4 million of net sales related to foreign customers , of which $44.8 million was in U.S. dollars and $22.6 was in Deutschemark-denominated sales. During fiscal 1999 the average monthly exchange rate for the Deutschemark to the U.S. dollar dropped by approximately 12% from .6103 to .5370 U.S. dollars to the Deutschemark, respectively.

In future periods, a significant portion of sales will be made in Deutschemarks until full integration of the "Euro" is achieved. The Company has not implemented a hedging strategy to reduce the risk of foreign currency translation exposures.

YEAR 2000 READINESS DISCLOSURE

This section contains certain statements that are forward-looking statements 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 Company's Year 2000 readiness, and the effects of the Year 2000 on the Company may be differ materially from currently projected. This may be due to, among other things, delays in the implementation of the Company's Year 2000 Plan, which includes contingency plans, and the failure of key third parties with whom the Company transacts business to achieve Year 2000 compliance. The Company faces risk to the extent that suppliers of products and services purchased by the Company and others with whom the Company transacts business on a world-wide basis do not have business products and services that comply with year 2000 requirements. The Company has obtained assurances from most of its key suppliers that their products and services are year 2000 compliant. In the event any such third parties cannot, in a timely manner, provide the Company with products and services that meet the year 2000 requirements, the Company's operating results could be materially adversely affected.

The Company began a comprehensive project in 1996 to prepare its products and its enterprise-wide information management system and other internal computer systems for the year 2000. The Company believes its implementation of a new enterprise-wide information management system, principally installed to improve operating efficiency, will address the Company's internal year 2000 compliance issues. The worldwide rollout of this system was completed on September 30, 1999.

Most of the Company's products are year 2000 compliant because there is very little or no date processing involved. Certain products, including end-of-life versions, do require customer action such as a patch or version upgrade to be compliant. These products have been identified, and the Company has notified impacted customers. Overall, management believes the year 2000 will not have a significant impact on operations.

The Company plans to continue with remediation and testing efforts with both its products and internal systems to further mitigate any risks associated with the year 2000. Contingency plans have been established in order to transact business at sufficient levels in the case of adverse events related to the Year 2000 date change. In addition, the Company will monitor the enterprise computer systems, LAN/WAN, and the computer room environments for temperature, continuous power supply, and transaction integrity. Facility personnel will be monitoring owned and leased buildings for heating and security.

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

YEAR 2000 READINESS DISCLOSURE (CONTINUED)

The costs associated with the year 2000 project have been minimal and are not incremental to the Company, but include temporary reallocation of existing resources. However, there can be no assurances that various factors relating to the Year 2000 compliance issues, including litigation, will not have a material adverse effect on the Company's business, operating results, or financial position.

While the Company believes it is prepared for Year 2000 issues and has an effective program in place to resolve the impact of a Year 2000 issue in a timely manner, there can be no assurance that the failure of the Company or of the third parties with whom the Company transacts business to adequately address their respective Year 2000 issues, will not have a material adverse effect on the Company's business, financial condition, cash flows and results of operations.

NEW ACCOUNTING STANDARDS

See Note 1 to the Company's consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED STATEMENTS OF OPERATIONS

For the fiscal years ended September 30	1999	1998 As Restated-See Note 2	1997
Net sales	$ 193,506,059	$ 182,931,670	$ 165,597,937
Cost of sales	95,313,636	88,539,156	85,482,536
Gross Margin	98,192,423	94,392,514	80,115,401
Operating expenses:			
Sales and marketing	41,002,559	37,288,027	36,671,271
Research and development	24,689,228	16,963,410	17,978,135
General and administrative	23,657,586	17,011,504	19,324,777
Acquired in-process research and development	-	16,064,933	-
Restructuring	607,398	1,020,000	10,471,482
Total operating expenses	89,956,771	88,347,874	84,445,665
Operating income (loss)	8,235,652	6,044,640	(4,330,264)
Other (expense) income, net	(256,320)	1,818,286	153,809
AetherWorks Corporation net operating loss	-	-	(5,764,201)
AetherWorks Corporation gain (write-off)	-	1,350,000	(5,758,548)
Income (loss) before income taxes	7,979,332	9,212,926	(15,699,204)
Provision for income taxes	4,787,599	9,284,020	91,640
Net income (loss)	$ 3,191,733	$ (71,094)	$ (15,790,844)
Net income (loss) per common share, basic	$ 0.22	$ (0.01)	$ (1.18)
Net income (loss) per common share, assuming dilution	$ 0.22	$ (0.01)	$ (1.18)
Weighted average common shares, basic	14,696,057	13,729,765	13,393,408
Weighted average common shares, assuming dilution	14,831,242	13,729,765	13,393,408

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

CONSOLIDATED BALANCE SHEETS

At September 30,	1999	1998 As Restated-See Note 2
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,963,607	$ 10,355,368
Marketable securities	13,714,422	-
Accounts receivable, net	33,955,669	47,087,978
Inventories, net	22,446,667	27,365,924
Other	5,394,346	6,139,941
Total current assets	96,474,711	90,949,211
Property, equipment and improvements, net	30,242,877	33,990,923
Intangible assets, net	47,804,611	63,602,435
Other	1,807,829	2,978,883
Total assets	$176,330,028	$191,521,452
LIABILITES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Borrowings under line of credit agreements	$ 4,759,095	$ 10,707,000
Current portion of long-term debt	330,028	264,025
Accounts payable	10,779,998	15,255,173
Income taxes payable	5,274,181	3,797,588
Accrued expenses:		
Advertising	2,461,437	2,651,742
Compensation	6,078,230	6,776,292
Other	6,357,348	8,347,668
Restructuring reserves	488,298	5,254,000
Total current liabilities	36,528,615	53,053,488
Long-term debt	9,205,918	11,124,446
Net deferred income taxes	3,431,133	5,817,933
Other	-	275,000
Total liabilities	49,165,666	70,270,867
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value: 2,000,000 shares authorized; none outstanding		
Common stock, $.01 par value; 60,000,000 shares authorized; 16,192,997 and 15,790,975 shares issued	161,930	157,910
Additional paid-in capital	71,460,612	70,461,123
Retained earnings	78,234,541	75,042,808
Cumulative foreign currency translation adjustment	(1,027,533)	(815,809)
	148,829,550	144,846,032
Unearned stock compensation	(339,686)	(1,700,635)
Treasury stock, at cost, 1,271,612 and 1,247,094 shares	(21,325,502)	(21,894,812)
Total stockholders' equity	127,164,362	121,250,585
Total liabilities and stockholders' equity	$176,330,028	$ 191,521,452

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the fiscal years ended September 30,	1999	1998 As Restated-See Note 2	1997
Operating activities:			
Net income (loss)	$ 3,191,733	$ (71,094)	$(15,790,844)
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Acquired in-process research and development		16,064,933	
Restructuring	(672,167)	1,020,000	9,211,713
Depreciation of property and equipment	5,988,640	5,174,725	5,587,132
Amortization of intangibles	12,807,568	3,665,879	1,114,023
AetherWorks Corporation net loss			5,764,201
AetherWorks Corporation (gain) write-off		(1,350,000)	5,758,548
Loss on sale of fixed assets	243,524	159,498	760,555
Provision for losses on accounts receivable	179,366	708,992	1,933,251
Provision for inventory obsolescence	6,218,261	3,414,270	2,910,988
Deferred income taxes	(2,119,056)	(1,251,611)	(1,787,933)
Stock compensation	582,981	895,401	244,569
Changes in operating assets and liabilities:			
Accounts receivable	12,359,264	(17,687,833)	15,283,125
Inventories	(1,618,415)	(569,839)	3,780,241
Income taxes payable	1,761,296	883,900	3,447,612
Other assets	2,228,897	(3,227,695)	713,772
Accounts payable	(3,822,046)	279,236	(2,430,817)
Accrued expenses and other liabilities	(4,025,827)	2,280,156	153,448
Total adjustments	30,112,286	10,460,012	52,444,428
Net cash provided by operating activities	33,304,019	10,388,918	36,653,584
Investing activities:			
Purchase of property and equipment and certain other intangible assets	(4,759,893)	(5,816,163)	(8,841,473)
Proceeds from sale of fixed assets	843,995		
Purchase of held-to-maturity marketable securities	(20,633,113)		
Proceeds form sale of held-to-maturity marketable securities	7,000,000		
Business acquisitions, net of cash acquired		(27,356,560)	
Investment in AetherWorks Corporation	-	(2,000,000)	(6,500,000)
Net cash used in by investing activities	(17,549,011)	(35,172,723)	(15,341,473)
Financing activities:			
Payments on long-term debt	(5,915,843)	(73,000)	
Proceeds from the issuance of long-term debt		2,064,865	
Purchase of treasury stock	(815,000)	(153,750)	
Stock option transactions, net	2,381,422	2,310,572	539,838
Employee stock purchase plan transactions, net	586,324	471,629	534,327
Net cash (used in) provided by financing activities	(3,763,097)	4,620,316	1,074,165
Effect of exchange rates changes on cash and cash equivalents	(1,383,672)	(810,809)	
Net increase (decrease) in cash and cash equivalents	10,608,239	(20,974,298)	22,386,276
Cash and cash equivalents, beginning of period	$ 10,355,368	$ 31,329,666	$ 8,943,390
Cash and cash equivalents, end of period	$ 20,963,607	$ 10,355,368	$ 31,329,666
Supplemental Cash Flows Information:			
Interest paid	$ 937,306	$ 224,730	$ 208,000
Income taxes paid	$ 3,742,898	$ 7,463,578	$ 238,439

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Consolidated Statements of Stockholders' Equity
For the years ended September 30, 1999, 1998 and 1997

	Common Stock Shares	Common Stock Par Value	Treasury Stock Shares	Treasury Stock Value	Additional Paid-in-Capital
Balances, September 30, 1996	14,677,150	$146,772	1,338,894	$(23,679,979)	$42,866,758
Employee Stock Purchase issuances			(69,402)	1,274,391	(740,064)
Issuance of stock options at below market prices					1,892,015
Stock compensation					
Issuance of stock upon exercise of stock options, net of withholding	50,106	501			379,720
Tax benefit realized upon exercise of stock options					159,617
Forfeiture of stock options					(154,944)
Net loss					
Balances, September 30, 1997	14,727,256	147,273	1,269,492	(22,405,588)	44,403,102
Issuance of stock for acquisitions	775,837	7,758			21,829,797
Purchase of treasury stock, at cost			15,000	(153,750)	
Employee Stock Purchase issuances			(37,398)	664,526	(192,897)
Issuance of stock options at below market prices					977,697
Stock compensation					
Issuance of stock upon exercise of stock options, net of withholding	287,882	2,879			2,307,742
Tax benefit realized upon exercise of stock options					1,305,001
Forfeiture of stock options					(169,319)
Foreign currency translation adjustment					
Net loss					
Balances, September 30, 1998 (As Restated-See Note 2)	15,790,975	157,910	1,247,094	(21,894,812)	70,461,123
Purchase of treasury stock, at cost			105,000	(815,000)	
Employee Stock Purchase issuances			(80,482)	1,384,310	(797,986)
Stock compensation					
Issuance of stock upon exercise of stock options, net of withholding	402,022	4,020			2,377,402
Tax benefit realized upon exercise of stock options					198,041
Forfeiture of stock options					(777,968)
Foreign currency translation adjustment					
Net income					
Balances, September 30, 1999	16,192,997	$161,930	1,271,612	$(21,325,502)	$71,460,612

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

Continued Next Page

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA (CONTINUED)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (CONTINUED)

Consolidated Statements of Stockholders' Equity
For the years ended September 30, 1999, 1998 and 1997

	Retained Earnings	Unearned Stock Compensation	Cumulative Translation	Total Stockholders' Equity	Comprehensive (Loss) Income
Balances, September 30, 1996	$ 90,904,746	$ (295,156)		$ 109,943,141	
Employee Stock Purchase issuances				534,327	
Issuance of stock options at below market prices		(1,892,015)			
Stock compensation		244,569		244,569	
Issuance of stock upon exercise of stock options, net of withholding				380,221	
Tax benefit realized upon exercise of stock options				159,617	
Forfeiture of stock options		154,944			
Net loss	(15,790,844)			(15,790,844)	$ (15,790,844)
Balances, September 30, 1997	75,113,902	(1,787,658)		95,471,031	$ (15,790,844)
Issuance of stock for acquisitions				21,837,555	
Purchase of treasury stock, at cost				(153,750)	
Employee Stock Purchase issuances				471,629	
Issuance of stock options at below market prices		(977,697)			
Stock compensation		895,401		895,401	
Issuance of stock upon exercise of stock options, net of withholding				2,310,621	
Tax benefit realized upon exercise of stock options				1,305,001	
Forfeiture of stock options		169,319			
Foreign currency translation adjustment			$ (815,809)	(815,809)	(815,809)
Net loss	(71,094)			(71,094)	(71,094)
Balances, September 30, 1998 (As Restated-See Note 2)	75,042,808	(1,700,635)	(815,809)	121,250,585	$ (886,903)
Purchase of treasury stock, at cost				(815,000)	
Employee Stock Purchase issuances				586,324	
Stock compensation		582,981		582,981	
Issuance of stock upon exercise of stock options, net of withholding				2,381,422	
Tax benefit realized upon exercise of stock options				198,041	
Forfeiture of stock options		777,968			
Foreign currency translation adjustment			(211,724)	(211,724)	(211,724)
Net income	3,191,733			3,191,733	3,191,733
Balances, September 30, 1999	$ 78,234,541	$ (339,686)	$ (1,027,533)	$ 127,164,362	$ 2,980,009

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BUSINESS DESCRIPTION

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

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

PRINCIPLES OF CONSOLIDATION

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

CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Those having original maturities in excess of three months are classified as marketable securities. Marketable Securities consist of high-grade commercial paper and have maturies of less than one year. Marketable securities classified as held to maturity are carried at amortized cost. Gross unrealized holding gains and losses were $10,561 and $5,383 as of September 30, 1999. The Company had no marketable securities as of September 30, 1998.

REVENUE RECOGNITION

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

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

INVENTORIES

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

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. Depreciation is provided by charges to operations using the straight-line method based on estimated useful lives, ranging from three to 39 years.

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

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

INTANGIBLE ASSETS

Purchased proven technology, license agreements, covenants not to compete and other intangible assets are recorded at cost. Goodwill represents the excess of cost over the fair value of identifiable assets acquired and is being amortized on a straight-line basis over estimated useful life periods ranging from five to 15 years. Purchased in process research and development costs (IPR&D) are expensed upon consummation of the purchase. All other intangible assets are amortized on a straight-line basis over their estimated useful lives of one to seven years.

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

RESEARCH AND DEVELOPMENT

Research and development costs are expensed when incurred. Software development costs are expensed as incurred. Such costs are required to be expensed until the point that technological feasibility and proven marketability of the product are established. Costs otherwise capitalized after such point also are expensed because they are insignificant.

INCOME TAXES

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INCOME TAXES (CONTINUED)

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

INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per share is calculated based on only the weighted average of common shares outstanding during the period. Net income (loss) per share, assuming dilution, is computed by dividing net income (loss) by the weighted average number of common and common equivalent shares outstanding. The Company's only common stock equivalents are those that result from dilutive common stock options. The calculation of diluted earnings per common share for 1999 includes 135,185 of such common stock equivalents. The calculation of diluted loss per common share for 1998 and 1997 excludes 835,670 and 236,165 equivalent shares, respectively, of the Company's common stock attributable to common stock options because their effect would be antidilutive.

FOREIGN CURRENCY TRANSLATION

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

USE OF ESTIMATES

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

COMPREHENSIVE INCOME

During the first quarter of fiscal 1999, the Company adopted Statement of Financial Accounting Standards No. 130 (FAS 130), "Reporting Comprehensive Income". FAS 130 requires the Company to report in the consolidated financial statements, in addition to net income, comprehensive income and its components including foreign currency items and unrealized gains and losses of certain investments in debt and equity securities. Comprehensive income is defined as "the change in equity (net assets) of a business enterprise during a period from transactions and other events and circumstances from non-owner sources." It includes all changes in equity during a period except those resulting from investment by owners and distributions to owners.

SEGMENT REPORTING

For the year ended September 30, 1999, the Company adopted Statement of Financial Accounting Standards No. 131 (FAS 131), "Disclosures about Segments of an Enterprise and Related Information". This statement establishes standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Under FAS 131, operating segments are to be determined consistent with the way that management organizes and evaluates financial information internally, makes operating decisions, and assesses performance.

RECLASSIFICATION OF CERTAIN ITEMS

Accrued sales discounts and allowances of $1,461,167, which previously were included in accrued expenses, have been reclassified into net accounts receivable for the year ended September 30, 1998. This reclassification had no impact on previously reported operating income, or net income.

Costs of $2,647,207 relating to systems support and communications costs, which previously were included in general and administrative expenses, have been reclassified into sales and marketing and research and development expenses for the year ended September 30, 1997. This reclassification had no impact on previously reported operating income, or net income.

NEW ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." Statement No. 133 will be effective for the Company beginning with the Company's fiscal year ending September 30, 2000. In July 1999, the FASB issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133" which defers the effective date of FASB 133 to the Company's fiscal year ending September 30, 2001. As the Company presently has no derivative instruments and is not involved in hedging activity, the Company does not expect the adoption of FASB Statement No. 133 and FASB Statement No. 137 to have an impact on the results of operations or the financial position of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NEW ACCOUNTING STANDARDS (CONTINUED)

In January 1999, the American Institute of Certified Public Accountants issued Statement of Position No. 98-9 (SOP 98-9), "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions." This SOP retains the limitations of SOP 97-2 on what constitutes vendor-specific objective evidence of fair value. SOP 98-9 will become effective for the Company's fiscal year ending September 30, 2000. The adoption of SOP 98-9 is not expected to have a significant impact on the results of operations or financial position of the Company.

In November 1999, the Staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 100 (SAB 100) - Restructuring and Impairment Charges. This SAB expresses the views of the Staff regarding the accounting for and disclosure of certain expenses commonly reported in connection with exit activities and business combinations. Although it has not made a definite determination of its impact, the Company does not expect the adoption of SAB 100 to have a materially adverse effect on its financial position or results of operation.

In December 1999, the Staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (SAB 101) - Revenue Recognition in Financial Statements. This SAB summarizes certain of the Staff's views in applying generally accepted accounting principals to revenue recognition in financial statements. Although it has not made a definite determination of its impact, the Company does not expect the adoption of SAB 101 to have a materially adverse effect on its financial position or results of operation.

2. RESTATEMENT

After discussion with the staff of the Securities and Exchange Commission (the SEC) the consolidated financial statements as of September 30, 1998 and for the year ended September 30, 1998 have been restated to reflect a change in the measurement and allocations of the purchase prices related to the July 1998 acquisitions of ITK and CDC.

The Company allocated amounts to IPR&D and intangible assets in the fourth quarter of 1998 in a manner consistent with widely recognized appraisal practices at the date of the acquisitions of ITK and CDC. Subsequent to the acquisitions, the SEC staff expressed broad views that took issue with certain appraisal practices generally employed by many public companies in determining the fair value of IPR&D. As a result of these developments, the Company has modified its valuation of IPR&D using the alternative income valuation approach. In addition, in response to questions raised by the SEC Staff about the Company's measurement of the fair value of common stock and common stock options issued in the ITK and CDC acquisitions, the Company has revised its valuation of this portion of the purchase prices.

As a result of valuing IPR&D using the alternative income valuation approach and adjusting the measurement of the purchase prices, the Company, in consultation with their independent accountants, has revised its measurement and allocations of the purchase prices, including the amounts allocated to IPR&D. The effect of these adjustments was to: reduce the aggregate amount originally allocated to IPR&D from $39.2 million to $16.1 million; increase the aggregate amount allocated to current

2. RESTATEMENT (CONTINUED)

technologies from $15.0 to $29.1 million; increase the amount of net deferred tax liabilities from $0 to $6.3 million; increase goodwill from $8.2 million to $27.4 million; increase additional paid in-capital from $68.7 million to $70.5 million; and reduce unearned stock compensation from $3.8 million to $1.7 million. These adjustments will also result in additional annual amortization expense related to identifiable intangibles and goodwill of approximately $5.0 million (assuming there are no future adjustments to reflect impairments of such intangibles and goodwill). The revised purchase accounting for the ITK and CDC acquisitions is described in detail in Note 3.

The restatement does not affect previously reported net cash flows for the periods. The effect of this reallocation on previously reported consolidated financial statements as of and for the year ended September 30, 1998 is as follows:

	As of and for the year ended September 30, 1998	
	As previously reported	As restated
Statement of Operations Data:		
General and administrative expenses	$ 16,003,146	$ 17,011,504
Acquired in-process research and development	39,200,000	16,064,933
Total operating expenses	110,474,583	88,347,874
Operating (loss) income	(16,082,069)	6,044,640
Loss before income taxes	(12,913,783)	9,212,926
Provision for income taxes	9,745,088	9,284,020
Net loss	$ (22,658,871)	$ (71,094)
Net loss per common share, basic	$ (1.65)	$ (0.01)
Net loss per common share, assuming dilution	$ (1.65)	$ (0.01)
Balance Sheet Data:		
Intangible assets, net	$ 31,354,483	$ 63,602,435
Total assets	160,734,667	192,982,619
Net deferred income taxes		5,817,933
Total liabilities	65,914,103	71,732,034
Additional paid-in capital	68,695,448	70,461,123
Retained earnings	52,455,031	75,042,808
Unearned stock compensation	(3,777,204)	(1,700,635)
Total stockholders' equity	$ 94,820,564	$ 121,250,585

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. ACQUISITIONS

In July 1998, the Company acquired all of the outstanding common stock of ITK International, Inc. (ITK). The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $3,484,000 (see Note 4).

Components of the purchase consideration, including related transaction costs, consist of $14,767,154 in cash, the Company's common stock with a market value of $12,501,183 and $2,316,415 of replacement stock options issued by the Company to ITK option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of ITK's common stock and the Company's stock options were issued in exchange for the outstanding ITK common stock options. The value of the Company's common stock issued was based on a per share value of approximately $21.69, calculated as the average market price of the Company's common stock during the two business days immediately preceding and subsequent to the date the parties reached agreement on terms and announced the transaction. The value of the Company's common stock options is based on the estimated fair value of these options, as of the date the transaction was consummated, using the Black-Scholes valuation model.

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

Cash and fair value of Company's common stock and common stock options issued	$ 28,146,369
Direct acquisition costs	1,438,383
ITK liabilities assumed, including estimated Restructuring and integration costs of $3,484,000	39,784,248
Total purchase price	$ 69,369,000
Estimated fair value of tangible assets acquired, including $5,772,000 of deferred taxes	27,440,814
Estimated fair value of:	
IPR&D	11,330,100
Identifiable intangible assets	21,100,000
Goodwill	17,727,086
Deferred tax liabilities related to identifiable intangibles	(8,229,000)
	$ 69,369,000

The Company utilized the alternative income valuation approach to determine the estimated fair value of the purchased in-process research and development. Management estimates that $11.3 million of the purchase price represents the fair value of purchased in-process research and development related to the VoIP projects referred to above, that had not yet reached technological feasibility and had no alternative future uses. These amounts were expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition. It is not certain that development efforts on these projects will allow for carrier class telephone company and end-user specifications to be met. Failure to achieve these specifications or to achieve market viability will cause the in-process Voice over Internet Protocol technology (VoIP) projects to fail. If these products are not successfully developed, the sales and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. ACQUISITIONS (CONTINUED)

profitability of the combined Company may be adversely affected in future periods. Additionally, the value of other identifiable intangible assets and goodwill acquired may become impaired.

The identifiable intangible assets of $21,100,000 included in the purchase price allocation set forth above are comprised of proven technology with an estimated fair value of $19,700,000 and an assembled workforce with an estimated fair value of $1,400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill, which is being amortized over seven years.

In July 1998, the Company acquired all of the outstanding common stock of Central Data Corporation (CDC). The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed, including estimated restructuring and integration costs of $750,000 (see Note 4).

Components of the purchase consideration, including related transaction costs, consist of $14,261,965 in cash, the Company's common stock with a market value of $4,326,721 and $2,693,236 of replacement stock options issued by the Company to CDC option holders. The cash and the Company's common stock were issued in exchange for outstanding shares of CDC's common stock and the Company's stock options were issued in exchange for the outstanding CDC common stock options. The value of the Company's common stock issued was based on a per share value of approximately $21.69, calculated as the average market price of the Company's common stock during the two business days immediately preceding and subsequent to the date the parties reached agreement on terms and announced the transaction. The value of the Company's common stock options is based on the estimated fair value of these options, as of the date the transaction was consummated, using the Black-Scholes valuation model.

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

Cash and fair value of Company's common stock and common stock options issued	$ 20,980,482
Direct acquisition costs	301,440
CDC liabilities assumed, including estimated restructuring and integration costs of $750,000	4,394,617
Total purchase price	$ 25,676,539
Estimated fair value of tangible assets acquired	5,252,408
Estimated fair value of:	
IPR&D	4,734,833
Identifiable intangible assets	9,800,000
Goodwill	9,711,298
Deferred tax liabilities related to identifiable intangibles	(3,822,000)
	$ 25,676,539

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. ACQUISITIONS (CONTINUED)

The Company utilized the alternative income valuation approach to determine the estimated fair value of the purchased in-process research and development. Management estimates that $4.7 million of the purchase price represents the fair value of purchased in-process research and development related to the USB projects referred to above, that had not yet reached technological feasibility and had no alternative future uses. These amounts were expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition. It is not certain that development efforts on these projects will allow for user specifications to be met or commercial viability to be achieved. Failure to achieve these specifications or to achieve market viability will cause the Universal Serial Bus (USB) projects to fail. If these products are not successfully developed, the sales and profitability of the combined Company may be adversely affected in future periods. Additionally, the value of other identifiable intangible assets and goodwill acquired may become impaired.

The identifiable intangible assets of $9,800,000 included in the purchase price allocation set forth above are comprised of proven technology with an estimated fair value of $9,400,000, and an assembled workforce with an estimated fair value of $400,000, which have estimated useful lives of five years and six years, respectively. The remaining unallocated purchase price represents goodwill, which is being amortized over seven years.

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

	1998	1997
Net sales	$220,271,670	$194,605,937
Net loss	($20,206,426)	($76,316,007)
Net loss per share	($1.36)	($5.39)

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

4. RESTRUCTURING

In March 1999, the Company's Board of Directors approved a restructuring plan related to the reorganization of sales and marketing functions in Germany, England and the United States, by consolidating worldwide sales and marketing resources into strategic locations. The original related charge of $1,452,909 ($581,164 net of tax benefits) consisted of $151,038 of existing commitments for rent on facilities vacated by the Company in Hamburg, Nurnberg, and Frankfurt, Germany and $1,301,871 of termination payments associated with the elimination of 44 positions in Dortmund, Germany, Bagshot, England, Sunnyvale, California, and Minneapolis, Minnesota.

As of September 30, 1999, the Company paid $836,953 of termination costs relating to the elimination of 33 positions. During the third quarter of fiscal 1999, management of the Company determined that $33,100 of severance costs in Dortmund would not be payable due to a decision to retain two employees previously notified that they would be terminated. In addition, the Company reduced its estimated

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. RESTRUCTURING (CONTINUED)

remaining rent commitment by $80,106 as it successfully sublet the vacated office space in Nurnberg, Germany. During the fourth quarter of fiscal 1999, management of the Company determined that $160,114 of severance costs in Minneapolis would not be payable due to a decision to retain two additional employees previously notified that they would be terminated. Adjustments to the restructuring accrual are reflected as a reduction in the restructuring accrual and a corresponding increase to operating income. Management of the Company expects that these restructuring activities will be completed by December 1999. A summary of payments and adjustments is included in the table below.

Description	Beginning Balance	Payments	Change in Estimate Adjustments	Balance at September 30, 1999
Severance and termination costs	$ 1,301,871	$ (836,953)	$ (193,214)	$ 271,704
Rent commitments	151,038	(50,460)	(80,106)	20,472
TOTAL	$ 1,452,909	$ (887,413)	$ (273,320)	$ 292,176

In July 1998, the Company's Board of Directors approved a restructuring plan related to the consolidation of its offices in Germany and England. The restructuring plan relates to the closure of existing leased facilities rendered redundant by the acquisition of ITK. The original charge of $1,020,000 ($647,000 net of tax benefits), consisted of $61,483 of noncancellable rent commitments the Company expected to incur following closure of the Cologne, Germany facility, $100,110 of contractual payment obligations for office furniture and other equipment the Company expected to incur following the closure of the Cologne, Germany facility, $202,039 related to the write-off of leasehold improvements in connection with the closure of the Cologne, Germany facility and $656,368 of termination payments associated with the elimination of six positions in Cologne, Germany and Bagshot, England.

The Company closed the Cologne facility during December 1998. As of September 30, 1999, the company paid $301,044 of termination costs relating to the elimination of two positions. During the third quarter of 1999, the Company reduced the restructuring accrual by $572,191 due to management's decision during the quarter to retain four employees previously notified that they would be terminated, a final settlement negotiated by the Company which reduced the remaining contractual rent commitments for office space and equipment in Cologne, Germany which was previously vacated and abandoned by the Company, and a decision by current management to utilize certain equipment which prior management had planned to abandon. Adjustments to the restructuring accrual are reflected as a reduction in the restructuring accrual and a corresponding increase to operating income. Restructuring activities have been completed as of June 1999. A summary of payments and adjustments is included in the table below.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. RESTRUCTURING (CONTINUED)

Description	Balance at September 30, 1998	Payments	Change in Estimate Adjustments	Balance at September 30, 1999
Severance and termination costs	$ 656,368	$ (301,044)	$ (355,324)	$ -
Rent commitments	61,483	(29,900)	(16,374)	15,209
Contractual payments for office equipment	100,110	(49,972)	(50,138)	-
Write-offs of leasehold improvements	202,039	(14,358)	(150,355)	37,326
TOTAL	$ 1,020,000	$ (395,274)	$ (572,191)	$ 52,535

In connection with the Company's acquisition of ITK, the Company formulated a plan of reorganization and accordingly, has recognized a $3,484,000 restructuring liability which the Company has included as a component of total liabilities assumed in the acquisition. Components of the original estimated liability included $1,844,000 of termination payments associated with 10 employees the Company expected to eliminate at the Chelmsford, Massachusetts ITK location and 20 employees the Company expected to eliminate at the Dortmund, Germany location and $1,640,000 of noncancellable rent obligations for facilities the Company expected to incur following closure of facilities in Chelmsford, Massachusetts and Bristol and Newbury, England.

The Company vacated the Chelmsford, Bristol, and Newbury facilities in March 1999, October 1998 and May 1999, respectively. During the third quarter of fiscal 1999, the Company reduced the restructuring accrual by $1,451,882 as management determined during the quarter that the number of positions to be terminated was 26 rather than 30 due to unanticipated employee turnover and other changes in management of the Company during fiscal 1999. In addition, during the third quarter of 1999, the Company and the lessor of the Newbury facility reached a final, negotiated settlement which significantly reduced the Company's remaining contractual rent obligation. Adjustments to the restructuring accrual are reflected as a reduction in the restructuring accrual and a corresponding decrease in goodwill. Restructuring activities have been completed as of June 1999. A summary of payments and adjustments is included in the table below.

Description	Balance at September 30, 1998	Payments	Change in Estimate Adjustments	Balance at September 30, 1999
Severance and termination costs	$ 1,844,000	$ (1,442,339)	$ (378,792)	$ 22,869
Facility closures	1,640,000	(531,513)	(1,073,090)	35,397
TOTAL	$ 3,484,000	$ (1,973,852)	$ (1,451,882)	$ 58,266

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. RESTRUCTURING (CONTINUED)

In connection with the Company's acquisition of CDC, the Company formulated a plan of reorganization and accordingly, the Company has recognized a $750,000 restructuring liability which the Company has included as a component of total liabilities assumed in the acquisition. Components of this estimated liability included $675,000 of termination payments, associated with 22 employees the Company expected to eliminate when it closed the Champaign, Illinois facility in January 1999 and $75,000 related to facility closure costs the Company expected to incur following closure and sale of the Champaign, Illinois facility.

During the third quarter of fiscal 1999, the Company reduced the restructuring accrual by $222,513 due to management's decision during the quarter to reduce the number of employees to be terminated from 22 to 20 due to unanticipated employee turnover and other changes in management. In addition, during the third quarter, management determined that it would not incur significant additional closure costs from the sale of the Champaign, Illinois facility. Adjustments to the restructuring accrual are reflected as a reduction in the restructuring accrual and a corresponding decrease in goodwill. Restructuring activities have been completed as of June 1999. A summary of payments and adjustments is included in the table below.

Description	Balance at September 30, 1998	Payments	Change in Estimate Adjustments	Balance at September 30, 1999
Severance and termination costs	$ 675,000	$ (442,166)	$ (147,513)	$ 85,321
Facility closure	75,000	-	(75,000)	-
TOTAL	$ 750,000	$ (442,166)	$ (222,513)	$ 85,321

In February 1997, the Company's Board of Directors approved a restructuring plan that resulted in a restructuring charge of $10,471,482 ($8,283,681, net of tax benefits). The corporate restructuring plan resulted in consolidation and reduced costs and expenses. It included the closing of the Cleveland manufacturing facility, the reduction of selected product lines and the consolidation and closing of the Torrance, California and Nashville, Tennessee research and development facilities. These costs included: (i) write downs of the carrying values of fixed assets related to the closed manufacturing and research and development facilities, (ii) write downs of the carrying values of goodwill and identifiable intangible assets (primarily licensing agreements related to the discontinued product lines) and related inventories, and (iii) severance costs associated with the elimination of 105 positions. These restructuring activities were completed in fiscal year 1997.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. SEGMENT INFORMATION AND MAJOR CUSTOMERS

The Company operates in one reportable segment as defined in FAS 131. The operations of the Company are primarily conducted in the Unites States, the Company's country of domicile. Geographic data, determined by references to the location of the Company's operations for the years ended September 30, are as follows:

Revenue by geographic area:

	Year Ended September 30,		
	1999	1998	1997
Unites States	$164,329,109	$171,385,998	$159,262,803
Europe	26,948,248	9,573,107	5,093,731
Asia	1,249,157	1,205,606	845,453
Australia	979,545	766,959	395,950
	$193,506,059	$182,931,670	$165,597,937

Long-lived assets by geographic area:

	Year Ended September 30,		
	1999	1998	1997
United States	$40,921,789	$48,218,876	$30,154,985
Foreign	37,125,699	49,374,482	339,308
Total long-lived assets	$78,047,488	$97,593,358	$30,494,293

The Company's foreign export sales, primarily to Europe, comprised 34.8%, 25.5%, and 26.9% of net sales for the years ended September 30, 1999, 1998 and 1997, respectively.

During 1999, one customer accounted for 15.4% of net sales and 8.7% of the trade accounts receivable as of September 30, 1999, while another accounted for 13.4% of net sales and 22.5% of the trade accounts receivable as of September 30, 1999.

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

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

6. INVESTMENT IN AETHERWORKS CORPORATION

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. INVESTMENT IN AETHERWORKS CORPORATION (CONTINUED)

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

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

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

For fiscal 1997, the Company reported its investment in AetherWorks on the equity method and reported net losses of $5,764,201. This loss, which excludes $5,758,548 of additional charges accrued as of September 30, 1997 as described below, represented 100% of AetherWorks net loss for the year. The percentage of AetherWorks net losses included in the Company's Statement of Operations was based upon the percentage of financial support provided by the Company (versus other investors) to AetherWorks that year.

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

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

OPERATING DATA FOR THE YEAR ENDED SEPTEMBER 30, 1997

Operating expenses:	
Research and development	$ 3,505,134
General and administrative	2,069,304
Other	1,169,345
Eliminations	(979,582)
Net loss	$ (5,764,201)

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

7. SELECTED BALANCE SHEET DATA

	1999	1998 As Restated-See Note 2
Accounts receivable, net:		
Trade accounts receivable	$42,720,227	$53,618,657
Less reserve for returns and doubtful accounts and sales allowances	8,764,558	6,530,679
	$33,955,669	$47,087,978
Inventories, net:		
Raw materials	$17,487,552	$16,814,657
Work in process	2,162,626	2,922,442
Finished goods	7,335,755	10,735,483
	26,985,933	30,472,582
Less reserve for obsolescence	4,539,266	3,106,658
	$22,446,667	$27,365,924
Property, equipment and improvements:		
Land	$ 2,533,666	$ 2,774,300
Building	19,338,618	19,912,614
Improvements	580,286	554,932
Equipment	22,991,088	20,859,857
Purchased software	8,872,121	6,968,127
Furniture & fixtures	1,462,338	929,890
	55,778,117	51,999,720
Less accumulated depreciation	25,535,240	18,008,797
	$30,242,877	$33,990,923
Intangible assets:		
Purchased technology	$30,010,858	$30,010,858
License agreements	2,559,067	3,476,400
Assembled workforce	1,800,000	1,800,000
Other	1,228,225	1,483,835
Goodwill	29,826,194	33,802,679
	65,424,344	70,573,772
Less accumulated amortization	17,619,733	6,971,337
	$47,804,611	$63,602,435

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. BORROWING UNDER LINE OF CREDIT AGREEMENTS

The Company maintains lines of credit with various financial institutions which provide for borrowings of up to $15,856,600. As of September 30, 1999 and 1998, $4,759,095 and $10,707,000 has been borrowed under these line of credit agreements. These line of credit agreements are uncollateralized and provide for interest rates ranging from 4.5% to 10.6% as of September 30, 1999 and 1998.

9. LONG-TERM DEBT

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

	1999	1998
5.5% fixed rate long-term collateralized note	$1,688,260	$ 1,854,490
5.2% fixed rate long-term collateralized note	1,143,660	1,256,240
6.3% fixed rate long-term collateralized note	4,356,800	4,784,959
6.0% fixed rate long-term uncollateralized note	1,960,560	1,555,010
5.0% to 10.6% subsidized long-term notes	386,666	525,851
6.0% fixed rate long-term collateralized note	-	538,450
Variable rate long-term collateralized note	-	250,000
Long-term collateralized mortgage note	-	623,471
	$9,535,946	$11,388,471
Less current portion	330,028	264,025
	$9,205,918	$11,124,446

The 5.5% fixed rate long-term note is payable in semi-annual installments beginning September 2000. The 5.2% fixed rate long-term note is payable in semi-annual installments beginning June 2001. The 6.3% fixed rate long-term note is payable in semi-annual installments beginning March 2000. Interest on the notes is payable on a quarterly basis. These notes are collateralized by land, buildings and equipment with a book value of $9,228,990. The 6.0% fixed rate long-term uncollateralized note is due in full on November 30, 2001. Interest is payable annually.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. LONG-TERM DEBT (CONTINUED)

The subsidized long-term notes bear interest rates ranging from 5% to 10.6% and are due at various dates through 2006. All borrowings under these notes are uncollateralized.

The 6.0% fixed rate long-term collateralized note, the variable rate long-term collateralized note, and the long-term collateralized mortgage note were paid in full during fiscal 1999.

Aggregate maturities of long-term debt are as follows:

Fiscal Year	
2000	$ 330,028
2001	397,013
2002	1,838,570
2003	675,304
2004	422,610
Thereafter	5,872,421
	$9,535,946

10. INCOME TAXES

The components of the provision for income taxes for the years ended September 30, 1999, 1998, and 1997 are as follows:

	1999	1998	1997
Currently payable:			
Federal	$ 6,201,277	$ 9,768,927	$ 1,737,116
State	705,378	766,704	142,457
Deferred	(2,119,056)	(1,251,611)	(1,787,933)
	$ 4,787,599	$ 9,284,020	$ 91,640

The net deferred tax asset (liability) at September 30, 1999 and 1998 consists of the following:

	1999	1998
Valuation reserves	$ 2,904,412	$ 2,673,443
Inventory valuation	228,442	430,501
Compensation costs	600,991	1,007,367
Net operating loss carryforwards	5,772,000	5,772,000
Intangible asset basis difference	(9,203,133)	(11,589,933)
Other	154,854	102,133
Net deferred tax asset (liability)	$ 457,566	$(1,604,489)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. INCOME TAXES (CONTINUED)

As of September 30, 1999 and 1998, the net deferred tax asset (liability) consists of current deferred tax assets of $3,888,699 and $4,213,444, respectively and net non-current deferred tax liabilities of $3,431,133 and $5,817,933, respectively. As of September 30, 1999 and 1998, the Company has recorded $9,203,133 and $11,589,933 of deferred tax liabilities related to the identifiable intangible assets that were acquired as part of the ITK and CDC acquisitions. These deferred tax liabilities are being amortized over the estimated useful lives of the related identifiable intangible assets acquired.

As of September 30, 1999 and 1998, the Company had federal net operating loss carryforwards of approximately $14,800,000 available to offset future taxable income, which expire at various dates through 2011. Utilization of such net operating loss carryforwards is presently limited to offset taxable income, if any, generated by ITK.

The reconciliation of the statutory federal income tax rate with the effective income tax rate for the years ended September 30, 1999, 1998, and 1997 is as follows:

	1999	1998	1997
Statutory income tax rate	35.0%	35.0%	(34.0) %
Increase (reduction) resulting from:			
Utilization of research and development tax credits			(0.9)
Utilization of low income housing credits	(5.0)	(3.9)	1.7
State taxes, net of federal benefits	5.7	5.4	
AetherWorks Corporation net operating loss			12.5
AetherWorks Corporation write-off			9.6
Acquired in-process research and development		61.0	
Restructuring charges			9.3
Tax contingencies			4.7
Nondeductible intangible asset amortization	15.3	2.7	1.3
Foreign operations	2.9	5.4	(0.2)
Other	6.1	(4.8)	(3.9)
	60.0%	100.8%	0.1 %

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

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

During the years ended September 30, 1999, 1998, and 1997, 402,022, 287,882, and 50,106 shares of the Company's Common Stock, respectively, were issued upon the exercise of options for 402,022, 289,353, and 50,167 shares, respectively. The difference between shares issued and options exercised results from the provision in the Plans allowing employees to elect to pay their withholding obligation through share reduction. Withholding taxes paid by the Company as a result of the share withholding provision amounted to $28,871 and $5,171 during the years ended September 30, 1998 and 1997, respectively. No employees elected to pay tax withhold obligations through share reduction during fiscal 1999.

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

During the year ended September 30, 1997 the Board of Directors authorized the cancellation and reissue of nonstatutory stock options to certain employees for the purchase of 823,326 shares, at an exercise price below the market value of the stock. Under this authorization, the original option issues were canceled and new options were issued with a new four-year vesting schedule.

The difference between the option price and market value at the date of grant for the above option arrangements has been recorded as additional paid-in capital with an offsetting debit within stockholders' equity to unearned stock compensation. The compensation expense related to these option grants is amortized to operations over the contractual vesting period in which employees perform services and amounted to $582,981 in 1999, $895,401 in 1998, and $244,569 in 1997.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

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

	Available For Grant	Options Outstanding	Weighted Average Price Per Share
Balances, September 30, 1996	354,514	2,336,660	$ 18.14
Additional shares approved for grant	500,000		
Granted	(1,509,701)	1,509,701	8.62
Exercised		(50,617)	7.71
Cancelled	1,879,636	(1,879,636)	19.01
Balances, September 30, 1997	1,224,449	1,916,108	$ 10.01
Additional shares approved for grant	750,000		
Granted	(1,254,525)	1,254,525	15.96
Exercised		(289,353)	8.56
Cancelled	150,013	(150,013)	12.79
Balances, September 30, 1998	869,937	2,731,267	$ 12.75
Granted	(1,019,100)	1,019,100	9.32
Exercised		(402,022)	$ 5.95
Cancelled	1,244,635	(1,244,635)	$ 14.26
Balances, September 30, 1999	1,095,472	2,103,710	$ 11.50

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

Commencing April 1996, the Company has sponsored an Employee Stock Purchase Plan (the Purchase Plan) which covers all domestic employees with at least 90 days of service. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Employee contributions to the plan were $586,324 in 1999, $658,118 in 1998, and $534,327 in 1997. Pursuant to the Purchase Plan, 80,482, 37,398, and 69,402 shares were issued to employees during the fiscal years ended 1999, 1998 and 1997, respectively. As of September 30, 1999, 303,883 shares are available for future issuances under the Purchase Plan.

12. STOCK-BASED COMPENSATION

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

Had the Company used the fair-value-based method of accounting for its stock options granted in 1999, 1998 and 1997, and charged operations over the option vesting periods based on the fair value of options at the date of grant, net income (loss) and net income (loss) per common share would have been changed to the following pro forma amounts:

	1999	1998	1997
Net income (loss):			
As reported	$ 3,191,733	$ (71,094)	$ (15,790,844)
Pro forma	$ 281,852	$ (3,244,655)	$ (17,449,611)
Net income (loss) per share - basic:			
As reported	$ 0.22	$ (0.01)	$ (1.18)
Pro forma	$ 0.02	$ (0.24)	$ (1.30)
Net income (loss) per share - assuming dilution:			
As reported	$ 0.22	$ (0.01)	$ (1.18)
Pro forma	$ 0.02	$ (0.24)	$ (1.30)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

12. STOCK-BASED COMPENSATION (CONTINUED)

The weighted average fair value of options granted in fiscal years 1999, 1998 and 1997 was $11.50 $12.29, and $12.47, respectively. The weighted average fair value was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

ASSUMPTIONS:	1999	1998	1997
Risk free interest rate	5.75%	5.49%	6.02%
Expected option holding period	4 years	4 years	4 years
Expected volatility	50%	60%	40%
Expected dividend yield	0	0	0

At September 30, 1999, the weighted average exercise price and remaining life of the stock options are as follows:

RANGE OF EXERCISE PRICES	$2.36-3.19	$5.91-8.88	$9.40-14.00	$14.31-20.88	$21.50-29.25	Total
Total options outstanding	49,009	1,087,279	515,769	217,715	233,938	2,103,710
Weighted average remaining contractual life (years)	4.91	8.13	8.14	6.66	6.70	7.75
Weighted average exercise price	$2.70	$7.66	$11.97	$17.71	$24.35	$11.50
Options exercisable	39,134	386,927	177,539	117,182	172,592	893,374
Weighted average price of exercisable options	$2.79	$7.99	$12.06	$17.29	$23.77	$12.84

13. SHARE RIGHTS PLAN

The Company has adopted a share rights plan. Under the plan, the Company distributed as a dividend one right for each share of the Company's common stock outstanding on June 30, 1998. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

14. COMMITMENTS

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

FISCAL YEAR	AMOUNT
2000	$ 1,224,904
2001	864,496
2002	411,944
2003	72,371
2004	72,371
Thereafter	$ 663,399

Total rental expense for all operating leases for the years ended September 30, 1999, 1998 and 1997 was $1,838,242, $1,786,715, and $1,405,582 respectively.

15. EMPLOYEE BENEFIT PLAN

The Company has a savings and profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code ("the Code"), whereby eligible employees may contribute up to 15% of their pre-tax earnings, not to exceed amounts allowed under the Code. In addition, the Company may make contributions to the plan at the discretion of the Board of Directors. The Company accrued $350,000 as a matching contribution for 1999. The Company provided a matching contribution of $240,000 in 1998 and no Company contribution was made in 1997.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

16. CONTINGENCIES

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

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

The 21 lead plaintiffs have moved for class certification with respect to the claims asserted in the Consolidated Amended Complaint. The Company and its former officers intend to oppose the motion. No date has been set for a hearing on the class certification motion. With the possible exception of additional depositions of certain lead plaintiffs, discovery in all of the actions has been completed.

The Company and its former officers served motions for summary judgment in all actions on November 19, 1999. Briefing on the motions is scheduled to be completed by February 4, 2000, and a hearing is expected to be held before the Court after that date.

The ultimate outcomes of these actions cannot be determined at this time, and no potential assessment of the probable or possible effects of such litigation if any, on the Company's financial position, liquidity or future operations can be made.

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

17. FOURTH QUARTER FISCAL 1998 INFORMATION (UNAUDITED)

During the third quarter of fiscal year 1998, management of the Company established $3 million of inventory valuation reserves including $1 million which related to an estimated overstatement of inventories resulting from certain system difficulties encountered in connection with the implementation of a new enterprise-wide computer system during the third quarter, and $2 million which related to estimated adjustments to the value of certain remote access server products which the Company believed were approaching technological obsolescence, primarily due to the expected introduction of the Company's new remote access server products in the fourth quarter of fiscal year 1998.

During the fourth quarter the Company was advised by a third-party vendor that it would delay delivery of a new modem which was integral to the Company's planned introduction of its new remote access server products. When the Company became aware of this delay, management reassessed the estimated timing and effect of technological obsolescence on the value of its old remote access product inventories, which resulted in a $900,000 reduction in the management's estimate of the required obsolescence provision in the fourth quarter.

In addition, in connection with its normal year-end closing procedures, the Company conducted a physical inventory count of its inventories as of September 30, 1998. This physical inventory count indicated that any previous inventory record discrepancies that had resulted from the system implementation were no longer impacting the Company's reported inventory balances as of September 30, 1998. Accordingly, the Company determined, during the fourth quarter, that the system difficulties encountered in the third quarter had been corrected and, therefore eliminated the related $1 million provision during the fourth quarter.

REPORT OF MANAGEMENT

TO THE STOCKHOLDERS OF DIGI INTERNATIONAL INC.

The Company's management is responsible for the integrity, objectivity and consistency of the financial information presented in this Annual Report on Form 10-K and the Company's 1999 Annual Report to Shareholders. The consolidated financial statements contained herein were prepared in accordance with generally accepted accounting principles and were based on informed judgments and management's best estimates as required. Financial information elsewhere in this annual report is consistent with that contained in the consolidated financial statements.

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

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

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

/s/ John P. Schinas

John P. Schinas
Chairman

/s/ Subramanian Krishnan

Subramanian Krishnan
Senior Vice President and Chief Financial Officer

December 28, 1999

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and stockholders' equity present fairly, in all material respects, the financial position of Digi International Inc. and subsidiaries (the Company) at September 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1999, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed more fully in Note 2, the Company and the staff of the Securities and Exchange Commission have had discussions regarding the accounting treatment related to the July 1998 acquisitions of ITK International, Inc. and Central Data Corporation. As a result of these discussions, the Company has changed the method used to allocate the purchase price to in-process technologies. In connection with this modification, the Company has adjusted the measurement and allocations of the purchase prices recorded for the aforementioned acquisitions. Accordingly, the consolidated financial statements as of and for the year ended September 30, 1998 have been restated.

As discussed in Note 6, the Company has recorded its investment in AetherWorks Corporation (AetherWorks) on the equity method; the 1997 consolidated statement of operations include AetherWorks' net operating loss for the year ended September 30, 1997 of $5,764,201. We did not audit the financial statements of AetherWorks, which statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for AetherWorks' net operating loss, is based solely on the report of other auditors.

/s/ PricewaterhouseCoopers LLP
Minneapolis, Minnesota
December 15, 1999

QUARTERLY FINANCIAL DATA (UNAUDITED)

In thousands except per share amounts	Quarter ended			
	Dec. 31	Mar. 31	June 30	Sept. 30
1999				
Net sales	$51,395	$42,631	$51,145	$48,335
Gross margin	26,491	18,478	27,147	26,076
Restructuring		1,453	(685)	(161)
Net income (loss)	475	(2,251)	2,253	2,715
Net income (loss) per share - basic	0.03	-0.15	0.15	0.18
Net income (loss) per share - assuming dilution	0.03	-0.15	0.15	0.18
1998 (a)				
Net sales	$42,590	$45,059	$46,449	$48,833
Gross margin	21,369	23,066	24,559 (b)	25,399 (b)
Acquired in-process research and development				16,065
Restructuring				1,020
AetherWorks Corporation gain			1,350	
Net income (loss)	3,842	4,665	6,411	(14,989)
Net income (loss) per share - basic	0.28	0.35	0.47	(1.05)
Net income (loss) per share - assuming dilution	0.27	0.33	0.45	(1.05)
1997				
Net sales	$42,236	$40,393	$40,843	$42,125
Gross margin	19,640	19,294	20,118	21,063
Restructuring		10,471		
AetherWorks Corporation net loss	(1,520)	(1,590)	(1,525)	(1,130)
AetherWorks Corporation write-off				(5,759)
Net (loss) income	(2,578)	(9,400)	67	(2,431)
Net (loss) income per share - basic	(0.19)	(0.70)	0.01	(0.29)
Net (loss) income per share - assuming dilution	(0.19)	(0.70)	0.01	(0.29)

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

(a) see Note 2 to the Company's consolidated financial statements.

(b) see Note 17 to the Company's consolidated financial statements.

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

None.

PART III

ITEM 10. EXECUTIVE OFFICERS OF THE REGISTRANT

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

Name	Age	Position
Joseph T. Dunsmore	41	President and Chief Executive Officer
Douglas J. Glader	56	Executive Vice President and Chief Operating Officer
Subramanian Krishnan	45	Senior Vice President and Chief Financial Officer

Mr. Dunsmore joined the Company on October 24, 1999, as President and Chief Executive Officer and as a member of the Board of Directors. Prior to joining Digi International, Mr. Dunsmore had been Vice President of Access for Lucent Microelectronics, a telecommunications company, since July 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 since May 1983.

Mr. Glader was named Executive Vice President and Chief Operating Officer on April 19, 1999, Vice President of Operations in February 1995 and Senior Vice President, Manufacturing Operations, on April 23, 1997. Before that, he was Director of Manufacturing and Operations for MiLAN Technology Corporation, which the Company acquired in November 1993. He began his career with Memorex Corporation and also worked for Measurex Corporation, Altus Corporation and Direct Incorporated. He founded and was Vice President of Operations for Greyhawk Systems, Inc., a manufacturer of electronic imaging hardware and software.

Mr. Krishnan was named Senior Vice President and Chief Financial Officer on February 1, 1999. Prior to joining the Company, he served as a principal with LAWCO Financial, an investment banking firm in Minneapolis, MN 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.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

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

1. Consolidated Statements of Operations for the fiscal years ended September 30, 1999, 1998 and 1997

   Consolidated Balance Sheets as of September 30, 1999 and 1998

   Consolidated Statements of Cash Flows for the fiscal years ended September 30, 1999, 1998 and 1997

   Consolidated Statements of Stockholders' Equity for the fiscal years ended September 30, 1999, 1998 and 1997

   Notes to Consolidated Financial Statements

   Report of Independent Accountants

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

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

(b) Reports on Form 8-K

Form 8-K/A dated August 18, 1999, regarding the Company's acquisition of ITK International, Inc. on July 29, 1998.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K (CONTINUED)

(c) Exhibits

Exhibit Number	Description
3(a)	Restated Certificate of Incorporation of the Company (1)
3(b)	Amended and Restated By-Laws of the Company (2)
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Norwest Bank Minnesota, National Association, as Rights Agent (3)
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Norwest Bank Minnesota, National Association, as Rights Agent (4)
10(a)	Stock Option Plan of the Company (5)
10(b)	Form of indemnification agreement with directors and officers of the Company (6)
10(c)	Amended and Restated Employment Agreement between the Company and John P. Schinas (7)
10(d)	Restated and Amended Note Purchase Agreement between the Company and AetherWorks Corporation, dated May 12, 1998

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K (CONTINUED)

(c) Exhibits (Continued)

Exhibit Number	Description
10(e)	Employment Arrangement between the Company and Jonathon E. Killmer, dated September 16, 1996 *(8)
10(f)	Employment Agreement between the Company and Jerry A. Dusa, dated March 12, 1997 *(9)
10(g)	Employment Arrangement between the Company and Douglas Glader *(10)
10(g)(i)	Amendment to Employment Agreement between the Company and Douglas Glader, dated September 24, 1999
10(h)	Employment Agreement between the Company and Dino G. Kasdagly, dated October 1, 1997 *(11)
10(i)	Agreement between the Company and Subramanian Krishnan dated March 26, 1999 *(12)
10(i)(i)	Amendment to Agreement between the Company and Subramanian Krishnan dated September 24, 1999 *
10(j)	Employment Agreement between the Company and Joseph T. Dunsmore dated October 24, 1999 *
10(k)	Employee Stock Purchase Plan of the Company (13)
13	1999 Annual Report to Stockholders (only those portions specifically incorporated by reference herein shall be deemed filed with the Securities and Exchange Commission)
21	Subsidiaries of the Company
23.1	Consent of Independent Accountants
23.2	Consent of Independent Accountants
24	Powers of Attorney
27	Financial Data Schedule

- -----------------

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

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K (CONTINUED)

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

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

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

(4) 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).

(5) Incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1998 (File no. 0-17972).

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

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

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

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

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

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

(12) 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).

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

REPORT OF INDEPENDENT AUDITORS

BOARD OF DIRECTORS AND SHAREHOLDERS
AETHERWORKS CORPORATION

We have audited the balance sheets of AetherWorks Corporation (a development stage company) as of September 30, 1997 and 1996, and the related statements of operations, shareholders' equity (deficit) and cash flows for the years then ended and the period from February 24, 1993 (inception) to September 30, 1997. These financial statements, not separately presented herein, are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

The financial statements referred to above have been prepared assuming the Company will continue as a going concern. As discussed in Note 11 to the financial statements, the Company's deficit accumulated during the development stage raises substantial doubt about its ability to continue as a going concern. The Company intends to obtain additional financing to permit it to continue its operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

Minneapolis, MN
October 28, 1997

SIGNATURES

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

DIGI INTERNATIONAL INC.

December 28, 1999 By: /s/ Joseph T. Dunsmore

Joseph T. Dunsmore
President and Chief Executive Officer

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

December 28, 1999 /s/ Joseph T. Dunsmore

Joseph T. Dunsmore
President and Chief Executive Officer
(Principal Executive Officer)

December 28, 1999 /s/ Subramanian Krishnan

Subramanian Krishnan
Sr. Vice President & Chief Financial Officer
(Principal Financial and Accounting Officer)

JOHN P. SCHINAS
WILLIS K. DRAKE
RICHARD E. EICHHORN
MYKOLA MOROZ A majority of the Board of Directors*
DAVID STANLEY
ROBERT S. MOE
KENNETH E. MILLARD
JOSEPH T. DUNSMORE

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 28, 1999 /s/ Subramanian Krishnan

Subramanian Krishnan
Attorney-in-fact

EXHIBIT INDEX

Exhibit	Description	Page
3(a)	Restated Certificate of Incorporation of the Registrant, as amended	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Registrant	Incorporated by Reference
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Norwest Bank Minnesota, National Association, as Rights Agent	Incorporated by Reference
4(b)	Amendment dated January 26, 1999, to Shares Rights greement, dated as of June 10, 1998 between Digi International Inc. and Norwest Bank Minnesota, National Association, as Rights Agent	Incorporated by Reference
10(a)	Stock Option Plan of the Registrant	Incorporated by Reference
10(b)	Form of indemnification agreement with directors and officers of the Registrant	Incorporated by Reference
10(c)	Amended and Restated Employment Agreement between the Registrant and John P. Schinas	Incorporated by Reference
10(d)	Restated and Amended Note Purchase Agreement between the Registrant and AetherWorks Corporation, dated May 12, 1998	Filed Electronically
10(e)	Employment Arrangement between the Registrant and Jonathon E. Killmer, dated September 16, 1996	Incorporated by Reference
10(f)	Employment Agreement between the Registrant and Jerry A. Dusa, dated March 12, 1997	Incorporated by Reference
10(g)	Employment Arrangement between the Registrant and Douglas Glader	Incorporated by Reference
10(g)(i)	Amendment to Employment Agreement between the Registrant and Douglas Glader, dated September 24, 1999	Filed Electronically
10(h)	Employment Agreement between the Registrant and Dino G. Kasdagly, dated October 1, 1997	Incorporated by Reference
10(i)	Agreement between the Company and Subramanian Krishnan dated March 26, 1999.	Incorporated by Reference
10(i)(i)	Amendment to the agreement between the Company and Subramanian Krishnan dated September 24, 1999.	Filed Electronically
10(j)	Employment Agreement between the Company and Joseph T. Dunsmore, dated October 24, 1999	Filed Electronically
10(k)	Employee Stock Purchase Plan of the Registrant	Incorporated by Reference
13	1999 Annual Report to Stockholders	Filed Electronically
21	Subsidiaries of the Company	Filed Electronically
23.1	Consent of Independent Accountants	Filed Electronically
23.2	Consent of Independent Accountants	Filed Electronically
24	Powers of Attorney	Filed Electronically
27	Financial Data Schedule	Filed Electronically

EXHIBIT 10(d)

AETHERWORKS CORPORATION
1998 NOTE PURCHASE AGREEMENT

This Agreement is made and entered into as of May 12, 1998 by and between AetherWorks Corporation, a Minnesota corporation (the "Company") and Digi International Inc., a Delaware corporation ("Digi"), sometimes referred to individually as a "Party" and collectively as the "Parties."

WHEREAS, On or about October 14, 1997 the Parties entered into the following agreements: 1997 Note Purchase Agreement, Note A, Note B, 1997 Shareholder Voting Agreement, 1997 Security Agreement, and Co-Sale Agreement (collectively, referred to herein as the "1997 Agreements"); and

WHEREAS, On or about September 12, 1997, the Parties entered into an Equipment Lease; and

WHEREAS, In order to facilitate a restructuring of the debt, and other rights and responsibilities contemplated by the 1997 Agreements;

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

1. Rescission of Certain Agreements; Releases

The 1997 Note Purchase Agreement, 1997 Shareholder Voting Agreement, and Co-Sale Agreement are hereby rescinded and shall be of no further force or effect. Each Party hereby releases the other Party, and each of its officers, directors and employees, from any obligations and all causes of action that are owed now or may arise in the future.

2. Amendment and Restatement of Certain Agreements and Instruments

2.1 Note A and Note B shall be amended and restated by issuance of a new note to Digi dated May 12, 1998 (the "1998 Note"), in the amount of Eight Million Dollars ($8,000,000) in the form of Exhibit 1, which shall fully satisfy the Company's obligations under Note A and Note B.

2.2 In the event the 1998 Note is lost, stolen or destroyed, and upon receipt of evidence of that fact and a bond of indemnity, reasonably satisfactory to the Company, the Company will issue a replacement note to Digi.

2.3 The Equipment Lease shall be amended and restated in the form of Exhibit 2 and shall be known as the "Amended and Restated Equipment Lease."

2.4 The 1997 Security Agreement shall be amended and restated in the form of Exhibit 3, and shall be known as the "1998 Amended and Restated Security Agreement." On or prior to the Closing Date, the Company and Digi agree to (i) terminate all documents and filings made in connection with the 1997 Security Agreement, (ii) execute all documents deemed necessary to release Digi's security interest in the collateral thereunder, and (iii) file all documents and filings necessary to perfect Digi's security interest in the Collateral as defined in the 1998 Amended and Restated Security

Agreement and Amended and Restated Equipment Lease, in form and substance mutually satisfactory to the Parties.

3. Release of Certain Guarantees

3.1 Schedule A attached hereto, includes a complete and correct list of all indebtedness, leases and other liabilities and obligation of the Company which have been previously guaranteed by Digi as of the date of this Agreement.

3.2 Digi shall be released by the Company from its obligation under the 1997 Documents to guarantee the obligation of the Company to Carlton Corporation, Koll Real Estate Company, and Central Computer Systems Inc.

3.3 In the case of the Company's obligations to Sanwa Leasing Corporation, Digi's guarantee shall remain in place, but shall be subordinated to the guarantee of a third party mutually agreed upon by the Parties (the "Third Party").

4. Non Competition Agreement

An Agreement (the "Non Competition Agreement") in the form of Exhibit 4, shall be executed by Jonathan A. Sachs on or before the execution of this Agreement.

5. Closing

The closing of the issuance of the 1998 Note by the Company to Digi and execution and exchange of other relevant documents to the satisfaction of the Parties, shall occur at the offices of Digi on May 12, 1998 (the "Closing Date"). At the Closing, the Company will deliver to Digi the executed 1998 Note, the Non Competition Agreement, and an executed agreement between the Company and Third Party, expressly assuming the guaranties defined in paragraph 3 above. At the Closing, Digi will deliver the 1997 Note Purchase Agreement, 1997 Shareholder Voting Agreement, 1997 Co-Sale Agreement for rescission and cancellation, as well as Note A and Note B, and partial releases for all previous UCCs, documents and other filings made in connection with the 1995 and 1997 Security Agreements.

6. Conditions to Closing

6.1 The representations and warranties of the Company in Section 7 shall be true in all material respects as of the Closing Date.

6.2 All registrations and qualifications required under applicable state securities laws for the lawful execution and delivery of this Agreement, and the offer, sale, issuance and delivery of the 1998 Note shall have been obtained.

6.3 Jonathan A. Sachs shall have entered into the Non Competition Agreement.

6.4 Concurrent with the execution of this Agreement, the Company will execute an agreement with Third Party providing for at least $5,000,000 over 9 months, contingent upon the occurrence of certain events, with at least $1,000,000 payable immediately to Company.

7. Representations and Warranties by Company

Except as disclosed in Schedule A hereto, the Company and its officers represent and warrant to Digi that:

7.1 The Company is a corporation duly organized, validly existing and in good standing under the laws of Minnesota. The Company has the requisite corporate power and authority to issue the 1998 Note and otherwise perform its obligations under this Agreement.

7.2 To the best of the Company's knowledge, except as contemplated by this Agreement, neither the execution nor delivery of this Agreement will result in any breach of, or constitute a default under, or result in the imposition of any lien or encumbrance upon any asset or property of the Company, pursuant to any applicable law, judgment, order or decree, or other instrument to which the Company is a party or by which it or any of its properties or assets or rights is bound or affected.

7.3 No consent, authorization, approval or filing with any governmental authority is required in connection with the execution and delivery of this Agreement and the offer, issuance, or delivery of the 1998 Note, other than the qualification, if required, under applicable state securities laws, which qualification has been or will be effected as a condition of this sale. Based on the advice of the Company's counsel, the 1998 Note will not under current laws and regulations require compliance with the prospectus delivery or registration requirements of the Securities Act of 1933, as amended (the Securities Act").

7.4 This Agreement has been duly authorized by all necessary corporate action on behalf of the Company, and has been duly executed and delivered by authorized officers of the Company. This Agreement is a valid and binding Agreement of the Company, enforceable in accordance with its terms.

7.5 Except as disclosed on Schedule A, there are not any legal actions pending against the Company.

7.6 The Company will provide Digi as much advance written notice as is possible in the event the Corporation expects to cease doing business as a going concern or expects to file voluntarily, or have filed against it involuntarily a petition for relief under the federal Bankruptcy Code.

8. Representations and Warranties of Digi

Digi and its officers represent and warrant to the Company that:

8.1 The 1998 Note is being purchased for Digi's own account and not with the view to, or for resale in connection with, any distribution or public offering within the meaning of the Securities Act.

8.2 Digi qualifies as an accredited investor under the Securities Act. Digi has such knowledge and experience in financial and business matters that Digi is capable of evaluating the merits and risks of the investment to be made hereunder by Digi.

8.3 Digi has had access to all of the Company's material books and records, and access to the Company's executive officers has been regularly provided to Digi.

8.4 This Agreement has been duly authorized by all necessary corporate action on behalf of Digi, and has been duly executed and delivered by authorized officers of Digi. This Agreement is a valid and binding Agreement of Digi, enforceable in accordance with its terms.

8.5 Digi agrees that it will make no public announcement or disclosure of any kind which identifies the name of Third Party.

9. Restriction of Transfer of Securities

The 1998 Note is transferable only pursuant to an effective registration under the Securities Act or an exemption therefrom and shall be endorsed with a restrictive legend to that effect.

10. Miscellaneous

10.1 Any modification or amendment of any provision of this Agreement must be in writing and signed by both of the Parties.

10.2 Neither this Agreement, nor any of the rights or obligations hereunder, shall be assignable without the prior written consent of the other Party.

10.3 The laws of Minnesota shall govern the validity of this Agreement.

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

DIGI INTERNATIONAL INC.

By: /s/ Jerry A. Dusa

Name: Jerry A. Dusa
Its: President and CEO

AETHERWORKS CORPORATION

By: /s/Jonathan A. Sachs

Name: Jonathan A. Sachs
Its: President and CEO

Exhibit 10(g)(i)

September 24, 1999

PERSONAL AND CONFIDENTIAL
Mr. Douglas J. Glader
Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

Dear Doug:

This letter confirms the terms of an amendment to your employment agreement with the Company dated February 6, 1995, as previously amended by letter agreement dated January 16, 1997 (the "Agreement"). Except as specifically provided for herein, the terms of the Agreement remain in full force and effect.

If you are terminated by the Company without "cause" on or before September 30, 2000, you would be entitled to severance equal to one year's base salary and a bonus (if earned) that would be pro-rated for the portion of the fiscal year through the termination date. The definition of "cause" is attached as an appendix to the Agreement. Neither this letter nor the Agreement shall be construed so as to amend the definition of "cause" contained in the terms and conditions of your options to purchase shares of the Company's Common Stock.

The Agreement as amended by this letter constitutes the entire agreement between you and the Company regarding the subject matter contained therein and supersedes all prior agreements and understandings relating thereto.

If the terms outlined above are acceptable, please confirm by signing the enclosed copy below and returning it to me.

Very truly yours,
DIGI INTERNATIONAL INC.

/s/ John P. Schinas

By John P. Schinas
Chairman of the Board

ACCEPTED:

/s/ Douglas J. Glader

Douglas J. Glader

Exhibit 10(i)(i)

September 24, 1999

PERSONAL AND CONFIDENTIAL
Mr. Subramanian Krishnan
Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

Dear Kris:

This letter confirms the terms of an amendment to your severance agreement with the Company as set forth in the letter agreement dated March 26, 1999 (the "Agreement"). Except as specifically provided for herein, the terms of the Agreement remain in full force and effect.

If you are terminated by the Company without "cause" on or before September 30, 2000, you would be entitled to severance equal to one year's base salary and a bonus (if earned), based on your cash bonus target that would be pro-rated for the portion of the fiscal year through the termination date.

The Agreement as amended by this letter constitutes the entire agreement between you and the Company regarding the subject matter contained therein and supersedes all prior agreements and understandings relating thereto.

If the terms outlined above are acceptable, please confirm by signing the enclosed copy below and returning it to me.

Very truly yours,
DIGI INTERNATIONAL INC.

/s/ John P. Schinas

By John P. Schinas
Chairman of the Board

ACCEPTED:

/s/ Subramanian Krishnan

Subramanian Krishnan

EXHIBIT 10(J)

EMPLOYMENT AGREEMENT
(Joseph T. Dunsmore)

This Agreement is made as of October 24, 1999 by and between DIGI INTERNATIONAL INC., a Delaware corporation (the "Company"), and Joseph T. Dunsmore (the "Executive").

WHEREAS the Company desires to employ Executive in accordance with the terms and conditions stated in this Agreement; and

WHEREAS Executive desires to accept that employment pursuant to the terms and conditions of this Agreement;

NOW THEREFORE, in consideration of the covenants and agreements contained herein, the parties hereto agree as follows:

I. EMPLOYMENT

1.1 Employment As Senior Executive. The Company hereby agrees to employ Executive, commencing the date hereof and continuing until the date his employment terminates pursuant to Article III hereof, in a senior executive capacity, initially as President and Chief Executive Officer of the Company. Executive accepts such employment pursuant to the terms of this Agreement. Executive shall perform such duties and responsibilities as may be determined from time to time by the Board of Directors of the Company, which shall be consistent with his position as a senior officer of the Company.

1.2 Exclusive Services. Commencing on the date hereof, Executive agrees to devote his full time, attention and energy to performing his duties and responsibilities to the Company under this Agreement, subject to a reasonable period, not to exceed four weeks, for transition from his former employment.

1.3 Vice Chairman; Chairman of the Board; Board Membership. The Company agrees that, no later than the next regularly scheduled Board meeting occurring on or after the date six months from the date hereof, the Board of Directors will consider electing Executive to the additional office of Vice Chairman. The Company agrees that, no later than the next regularly scheduled Board meeting occurring on or after the second anniversary of the date hereof, the Board of Directors will consider electing Executive to the additional office of Chairman of the Board. Concurrently with execution of this Agreement Executive has been elected a director of the Company.

II. COMPENSATION, BENEFITS AND PERQUISITES

2.1 Base Salary. During the period this Agreement is in effect, the Company shall pay Executive a base salary at the annual rate of $260,000, payable semi-monthly; provided, however, that Executive shall be paid a base salary at the annual rate of $125,000, payable semi-monthly, until he assumes his duties on a full-time basis. Beginning on or about October 1, 2000, the Board of Directors of the Company (the "Board", which term shall include a duly authorized committee of the Board of Directors) will review the base salary annually, and may in its sole discretion increase it to reflect performance and other factors. However, the Board is not obligated to provide for any increases.

2.2 Bonuses. Beginning with the fiscal year ending September 30, 2001, Executive shall be eligible to receive a cash performance bonus of up to 100% base salary paid for each fiscal year during which this Agreement is in effect, as follows:

(a) Executive shall be entitled to the target bonus amount if the objectives set by the Board of Directors in its sole discretion for the fiscal year are met. Such objectives may include, in the sole discretion of the Board, the achievement of financial objectives set forth in the Board-approved business plan (the "Business Plan") for a particular fiscal year, or such other objectives as the Board, in its sole discretion, shall determine.

(b) If some or all of the objectives are not met for a fiscal year, then the Board will determine in its discretion what portion, if any, of the target bonus amount will be paid to Executive for that year.

(c) The target bonus for each fiscal year shall be paid to Executive on September 30 of each year or as soon thereafter as the Company determines whether the objectives for such bonus have been met for that year.

(d) In any fiscal year in which the objectives for the cash bonus are based upon financial objectives in the Board-approved Business Plan for such fiscal year, the Board will consult with Executive before determining the Business Plan for each fiscal year. However, the Board will have authority to establish the Business Plan for each year in its sole discretion.

(e) In any fiscal year in which the objectives for the cash bonus are based upon financial objectives in the Board-approved Business Plan for such fiscal year, the objectives set by the Company's Board-approved Business Plan for such fiscal year shall not be adjusted for the acquisition, by any means, of any businesses or business units (and expenses related thereto) that may occur during a particular fiscal year. The objectives set by the Company's Board-approved Business Plan for any such fiscal year shall be equitably adjusted by the Board for the divestiture, by any means, of any businesses or business units (and expenses related thereto) that may occur during a particular fiscal year and to eliminate any reorganization, restructuring or other extraordinary charge that may be incurred during a particular fiscal year.

2.3 Bonus for Fiscal 2000. Executive shall be eligible to receive a guaranteed cash bonus of $260,000 (prorated for the portion of the fiscal year from the date hereof to September 30, 2000) payable as follows:

(a) $110,000, promptly upon request of Executive, and

(b) the balance on September 30, 2000.

In the event that Executive's employment with the Company terminates before September 30, 2000 except as a result of a termination by the Company other than for "cause" (as hereinafter defined), Executive shall not be entitled to any cash bonus for fiscal 2000 and shall promptly repay the $110,000 (net of any tax withholding) to be advanced to him.

2.4 Overachievement Bonuses. If the objectives set by the Board of Directors for a cash performance bonus are exceeded for a fiscal year, the Board may in its discretion award Executive a bonus that is larger than the target bonus.

2.5 Stock Options. As of the date of this Agreement, Executive has been awarded an incentive stock option and a non-statutory stock option under the Digi International Inc. Stock Option Plan (the "Stock Option Plan") for an aggregate of 240,000 Common Shares of the Company (as defined in the Stock Option Plan), on the terms set forth on Schedule I. On or about September 30 of each year the Compensation Committee of the Board of the Company considers and awards stock options to key employees of the Company and its subsidiaries. These awards are made in the discretion of the Compensation Committee and are principally intended to recognize performance over the preceding fiscal year.

2.6 Form of Stock Option Agreement. Stock option awards to Executive shall be pursuant to stock option agreements in substantially the form of Schedule II and III, with such additions thereto and deletions therefrom as Executive and the Chairman of the Board, the Chairman of the Compensation Committee or another duly authorized officer of the Company shall agree, such agreement to be conclusively evidenced by their execution and delivery thereof.

2.7 Vacations. Executive shall be entitled to vacation in accordance with policies of the Company.

2.8 Employee Benefits. Executive shall be entitled to the benefits and perquisites which the Company generally provides to its other senior executives under the applicable

Company plans and policies, and to future benefits and perquisites made generally available to senior executives of the Company. Executive's participation in such benefit plans shall be on the same basis as applies to other senior executives of the Company. Executive shall pay any contributions which are generally required of senior executives to receive any such benefits.

2.9 Employment Taxes and Withholding. Executive recognizes that the compensation, benefits and other amounts provided by the Company under this Agreement may be subject to federal, state or local income taxes. It is expressly understood and agreed that all such taxes shall be the responsibility of the Executive. To the extent that federal, state or local law requires withholding of taxes on compensation, benefits or other amounts provided under this Agreement, the Company shall withhold the necessary amounts from the amounts payable to Executive under this Agreement.

2.10 Company Responsibility for Insured Benefits. In this Article II, the Company is agreeing to provide certain benefits which are provided in the form of premiums of insurance coverage. The Company is not itself promising to pay the benefit an insurance company is obligated to pay under the policy the insurance company has issued. If an insurance company becomes insolvent and cannot pay benefits it owes to Executive or his beneficiaries under the insurance policy, neither Executive nor his personal representative or beneficiary shall have any claim for benefits against the Company. The insurance companies presently providing such benefits are as set forth in the Company's benefits enrollment booklet previously delivered to Executive. In addition, the Company presently provides $500,000 of term life insurance to senior executives through First Colonial Life Insurance Company and director and officer liability coverage, with a $10 million policy limit, through Zurich Insurance Company.

2.11 Expenses. During the term of his employment hereunder, Executive shall be entitled to receive prompt reimbursement from the Company (in accordance with the policies and procedures in effect for the Company's employees) for all reasonable travel and other expenses incurred by him in connection with his services hereunder.

2.12 Relocation. Executive shall relocate to the general vicinity of the Minneapolis/St. Paul metropolitan area. The Company will (i) pay for Executive's direct relocation expenses, including the cost of moving Executive's household goods, in accordance with the provisions of the Company's relocation policies and practices for senior executives, and, (ii) as promptly as practicable, accept conveyance of Executive's residence located at 11 Wyckoff Road, Hampton, New Jersey, subject to review and acceptance of title, and, as consideration for such conveyance, pay Executive (or if applicable, Executive and his spouse) his documented purchase price for such residence, with the proceeds of sale applied first to discharge Executive's mortgage, and the balance paid to Executive (or if applicable, Executive and his spouse) in cash.

2.13 Payment of Amounts Related to Previous Employment. The Company acknowledges that, because the Executive has accepted employment with the Company, he may be required to repay certain amounts to his previous employer, all of which amounts are specifically itemized on Schedule IV attached to this Agreement. As to each amount listed on Schedule IV, after the Executive's previous employer requires the Executive to repay such amount and after the Executive provides suitable documentation to the Company of his previous employer's position regarding such repayment, the Company shall promptly pay such amount to the Executive, together with an additional amount of cash sufficient to pay any personal income tax payable as a result of the Company's payments to Executive under this Section 2.13.

III. TERMINATION OF EXECUTIVE'S EMPLOYMENT

3.1 Termination of Employment. Executive's employment under this Agreement may be terminated by the Company at any time for any reason; provided, however, that if Executive's employment is terminated by the Company during the term of this Agreement for a reason other than for cause, he shall be entitled to continue to receive his base salary under Section 2.1 (i) for a period of 24 months from his date of termination in the event of termination on or before 6 months of the date hereof, (ii) for a period of 18 months from his date of termination in the event of termination after 6 months and on or before one year from the date hereof, and (iii) for a period of 12 months from his date of termination in the event of termination after one year from the date hereof. Executive's employment under this Agreement may be terminated by Executive at any time for any reason. The termination shall be effective as of the date specified by the party initiating the termination in a written notice delivered to the other party, which date shall not be earlier than the date such notice is delivered to the other party. Except as expressly provided to the contrary in this section or applicable law, Executive's rights to pay and benefits shall cease on the date his employment under this Agreement terminates. This Agreement shall terminate in its entirety immediately upon the death of Executive. In no event shall the Company's election not to extend the term of this Agreement pursuant to Section 5.11 be deemed to be termination by the Company for a reason other than cause.

3.2 Cause. For purposes of this Article III, "cause" shall mean only the following: (i) indictment or conviction of, or a plea of nolo contendere to, (A) any felony (other than any felony arising out of negligence), or any misdemeanor involving moral turpitude with respect to the Company, or (B) any crime or offense involving dishonesty with respect to the Company; (ii) theft or embezzlement of Company property or commission of similar acts involving dishonesty or moral turpitude; (iii) repeated material negligence in the performance of Executive's duties after notice; (iv) Executive's failure to devote substantially all of his working time and efforts during normal business hours to the Company's business; (v) knowing engagement in conduct which is materially injurious to the Company; (vi) knowing failure, for Executive's own benefit, to comply with the covenants contained in Sections 4.1 or 4.2 of this Agreement; (vii) knowingly providing materially misleading information concerning the Company to the Company's Board of Directors, any governmental body or regulatory agency or to any lender or other financing source or proposed financing source of the Company; or (viii) failure of the Company to meet at least 70% of the Board-approved Business Plan for either net sales or after tax earnings in any fiscal year, calculated in accordance with Section 2.2.

3.3 Disability. If Executive has become disabled from substantially performing his duties under this Agreement and the disability has continued for a period of more than ninety (90) days, the Board may, in its discretion, determine that Executive will not return to work and terminate his employment under this Agreement. Upon any such termination for disability, Executive shall be entitled to such disability, medical, life insurance, and other benefits as may be provided generally for disabled employees of the Company during the period he remains disabled.

3.4 Resignation. Executive agrees that, upon termination of Executive's employment hereunder for any reason, he shall be deemed to have resigned as a director of the Company and as a director, officer and/or employee of any parent company of the Company or any of their subsidiaries, unless prior to termination of Executive's employment hereunder the provisions of this Section 3.4 shall have been waived by vote of the Board (excluding Executive).

IV. NON-COMPETITION, CONFIDENTIALITY AND TRADE SECRETS

4.1 Agreement Not to Compete. In consideration of the covenants and agreements contained in this Agreement, Executive agrees that, on or before the date which is one year after the date Executive's employment by the Company, any parent company of the Company or any of their subsidiaries terminates, he will not, unless he receives the prior approval of the Board of Directors of the Company, directly or indirectly engage in any of the following actions:

(a) Own an interest in (except as provided below), manage, operate, join, control, lend money or render financial or other assistance to, or participate in or be connected with, as an officer, employee, partner, stockholder, consultant or otherwise, any entity whose products or services compete with those of the Company, any parent company of the Company, or any of their subsidiaries. However, nothing in this subsection (a) shall preclude Executive from holding less than one percent of the outstanding capital stock of any corporation required to file periodic reports with the Securities and Exchange Commission under Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the securities of which are listed on any securities exchange, quoted on the Nasdaq National Market or Nasdaq SmallCap Market or traded in the over-the-counter market.

(b) Intentionally solicit, endeavor to entice away from the Company, any parent company of the Company or any of their subsidiaries, or otherwise interfere with the relationship of the Company, any parent company of the Company or any of their subsidiaries with, any person who is employed by or otherwise engaged to perform services for the Company, any parent company of the Company or any of their subsidiaries (including, but not limited to, any independent sales representatives or organizations), or any persons or entity who is, or was within the then most recent 12-month period, a customer or client of the Company, any parent company of the Company or any of their subsidiaries, whether for Executive's own account or for the account of any other individual, partnership, firm, corporation or other business organization.

If the scope of the restrictions in this section are determined by a court of competent jurisdiction to be too broad to permit enforcement of such restrictions to their full extent, then such restrictions shall be construed or rewritten (blue-lined) so as to be enforceable to the maximum extent permitted by law, and Executive hereby consents, to the extent he may lawfully do so, to the judicial modification of the scope of such restrictions in any proceeding brought to enforce them.

4.2 Non-Disclosure of Information. During the period of his employment hereunder, and at all times thereafter, Executive shall not, without the written consent of the Board of Directors, disclose to any person, other than an employee of the Company, any parent company of the Company or any of their subsidiaries or a person to whom disclosure is reasonably necessary or appropriate in connection with the performance by Executive of his duties as an executive of the Company, except where such disclosure may be required by law, any material confidential information obtained by him while in the employ of the Company, any parent company of the Company or any of their subsidiaries with respect to any products, technology, know-how or the like, services, customers, methods or future plans of the Company, any parent company of the Company or any of their subsidiaries, all of which Executive acknowledges are valuable, special and unique assets, the disclosure of which Executive acknowledges may be materially damaging.

4.3 Remedies. Executive acknowledges that the Company's remedy at law for any breach or threatened breach by Executive of Section 4.1 or Section 4.2 will be inadequate. Therefore, the Company shall be entitled to injunctive and other equitable relief restraining Executive from violating those requirements, in addition to any other remedies that may be available to the Company under this Agreement or applicable law.

4.4 Proprietary Information and Employment Limitations. Executive agrees that no trade secret or proprietary information belonging to his previous employers will be disclosed or used by him at the Company, and that no such information, whether in the form of documents, memoranda, software, drawings, etc. will be retained by him or brought with him to the Company. Executive represents and warrants to the Company that he has brought to the Company's attention and provided it with a copy of any agreement which may impact his future employment by the Company, including non-disclosure, non-competition, invention assignment agreements or agreements containing future work restrictions, and that he is subject to no restrictions under any agreement of this type that would impact his employment by the Company.

V. MISCELLANEOUS

5.1 Amendment. This Agreement may be amended only in writing, signed by both parties and approved by the Board.

5.2 Entire Agreement. Before signing this Agreement the parties had numerous conversations, including preliminary discussions, formal negotiations and informal conversations, and generated correspondence and other writings, in which the parties discussed the employment which is the subject of this Agreement and their aspirations for its success. In such conversations and writings, individuals representing the parties may have expressed their judgments and beliefs concerning the intentions, capabilities and practices of the parties, and may have forecasted future events. The parties recognize that such conversations and writings often involve an effort by both sides to be positive and optimistic about the prospects for the employment. It is also recognized, however, that all business transactions contain an element of risk, and that it is normal business practice to limit the legal obligations of contracting parties to only those promises and representations which are essential to their transaction so as to provide certainty as to their respective future rights and remedies. Accordingly, this Agreement is intended to define the full extent of the legally enforceable undertakings of the parties hereto, and no related promise or representation, written or oral, which is not set forth explicitly in this Agreement is intended by either party to be legally binding. Both parties acknowledge that in deciding to enter into this transaction they have relied on no representations, written or oral, other than those explicitly set forth in this Agreement. Executive has relied entirely on his own judgment and that of his advisers in entering into this Agreement.

5.3 Assignment. The Company may in its sole discretion assign this Agreement to any entity which succeeds to some or all of the business of the Company through merger, consolidation, a sale of some or all of the assets of the Company, or any similar transaction. Executive acknowledges that the services to be rendered by him are unique and personal. Accordingly, Executive may not assign any of his rights or obligations under this Agreement.

5.4 Successors. Subject to Section 5.3, the provisions of this Agreement shall be binding upon the parties hereto, upon any successor to or assign of the Company, and upon Executive's heirs and the personal representative of Executive or Executive's estate.

5.5 Notices. Any notice required to be given under this Agreement shall be in writing and shall be delivered either in person or by certified or registered mail, return receipt requested. Any notice by mail shall be addressed as follows:

If to the Company, to:

Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

Attention: Chairman of the Board

With a copy to:

Faegre & Benson LLP
2200 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402-3601
Attention: James E. Nicholson

If to Executive, to:

Joseph T. Dunsmore
Digi International Inc.
11001 Bren Road East
Minnetonka, MN 55343

or to such other addresses as either party may designate in writing to the other party from time to time.

5.6 Waiver of Breach. Any waiver by either party of compliance with any provision of this Agreement by the other party shall not operate or be construed as a waiver of any other provision of this Agreement, or of any subsequent breach by such party of a provision of this Agreement. No waiver by the Company shall be valid unless in writing and signed by the Chairman of the Board of Directors or Chairman of the Compensation Committee.

5.7 Severability. If any one or more of the provisions (or portions thereof) of this Agreement shall for any reason be held by a final determination of a court of competent jurisdiction to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provisions (or portions of the provisions) of this Agreement, and the invalid, illegal or unenforceable provisions shall be deemed replaced by a provision that is valid, legal and enforceable and that comes closest to expressing the intention of the parties hereto.

5.8 Governing Law. THIS AGREEMENT SHALL BE INTERPRETED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF MINNESOTA, APPLICABLE TO CONTRACTS EXECUTED AND FULLY PERFORMED WITHIN THE STATE OF MINNESOTA WITHOUT GIVING EFFECT TO CONFLICT OF LAW PRINCIPLES. EXECUTIVE HEREBY IRREVOCABLY SUBMITS TO THE JURISDICTION OF ANY MINNESOTA STATE OR FEDERAL COURT IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT, AND THE COMPANY AND EXECUTIVE HEREBY IRREVOCABLY AGREE THAT ALL CLAIMS IN RESPECT OF SUCH ACTION OR PROCEEDING MAY BE HEARD AND DETERMINED ONLY IN SUCH MINNESOTA STATE COURT OR SUCH FEDERAL COURT AND IN NO OTHER COURT. EXECUTIVE HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT HE MAY EFFECTIVELY DO SO, THE DEFENSE OF AN INCONVENIENT FORUM TO THE MAINTENANCE OF SUCH ACTION OR PROCEEDING. EACH OF THE COMPANY AND EXECUTIVE HEREBY IRREVOCABLY CONSENTS TO THE SERVICE OF COPIES OF THE SUMMONS AND COMPLAINT AND ANY OTHER PROCESS WHICH MAY BE SERVED IN ANY SUCH ACTION OR PROCEEDING BY CERTIFIED MAIL, RETURN RECEIPT REQUESTED, OR BY DELIVERING OF A COPY OF SUCH PROCESS TO OF THE COMPANY OR EXECUTIVE, AS THE CASE MAY BE, AT THE RESPECTIVE ADDRESS SPECIFIED IN SECTION 5.5 OR BY ANY OTHER METHOD PROVIDED BY LAW. EACH OF THE COMPANY AND EXECUTIVE AGREES THAT A FINAL JUDGMENT IN ANY SUCH ACTION OR PROCEEDING SHALL BE CONCLUSIVE AND MAY BE ENFORCED IN OTHER JURISDICTIONS BY SUIT ON THE JUDGMENT OR BY ANY OTHER MANNER PROVIDED BY LAW.

5.9 Headings. The headings of articles and sections herein are included solely for convenience and reference and shall not control the meaning or interpretation of any of the provisions of this Agreement.

5.10 Counterparts. This Agreement may be executed by either of the parties hereto in counterparts, each of which shall be deemed to be an original, but all such counterparts shall constitute a single instrument.

5.11 Automatic Renewal. Unless terminated at an earlier date in accordance with Section 3.1, the term of the Executive's employment with the Company hereunder shall be for the period commencing on the date hereof and ending on September 30, 2001. Unless terminated at an earlier date in accordance with Section 3.1, on each September 30, beginning September 30, 2000 (the "Renewal Date"), the term of the Executive's employment with the Company shall be automatically extended for successive two-year periods, unless either party gives written notice to the other party at least 60 days prior to the next Renewal Date that such party elects not to extend the term of this Agreement.

IN WITNESS WHEREOF, the parties have executed this Agreement in Minnetonka, Minnesota, effective as of the date set forth above.

DIGI INTERNATIONAL INC.

By /s/ John P. Schinas

Its Chairman of the Board

EXECUTIVE

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore

1999 ANNUAL REPORT

DIGI INTERNATIONAL INC.'s product line includes the most used communications adapter boards for server-based-systems. We have the products and partnerships to succeed in today's computing environment.

Digi international (Nasdaq: DGII) is the world's leading supplier of multi-function adapters for server-powered communications. Digi's products, including its DataFire(R) digital adapters and AccelePort(R) multi-port serial adapters, are an integral part of server-based communications systems for applications such as point of sale, remote access, fax, routing, computer telephony and Internet access.

Server-based communications solutions are a growing market, and offer several advantages over competitive solutions based on stand-alone proprietary boxes. These include low cost of ownership; increased flexibility and scalability; dependability and simplified training and support. Server-based solutions also offer channel partners the ability to add value and increase profits by using industry-leading standard PC servers, operating systems and best-of-breed software applications.

Digi sells and markets its products through a global network of distributors, integrators, resellers and OEMs. The company maintains strong development and marketing partnerships with industry-leading hardware, software and operating system vendors. Digi also has a customer base that includes many of the world's largest companies, including IBM, AT&T, Siemens and others.

Digi is based in Minnetonka, Minnesota, and employs more than 575 people worldwide.

This annual report, including the data set forth below, should be read in conjunction with Digi International Inc.'s Annual Report on Form 10-K for the year ended September 30, 1999, which includes Digi's financial statements, notes thereto and other information regarding the Company.

financial highlights

	1999	1998	1997	1996	1995
Net sales	$ 193,506	$ 182,932	$ 165,598	$ 193,151	$ 164,978
Acquired in-process research and development		16,065			
Restructuring	607	1,020	10,472		
AetherWorks Corporation net operating loss			(5,764)	(3,624)	
AetherWorks Corporation gain (write-off)		1,350	(5,759)		
Income (loss) before taxes	7,979	9,213	(15,699)	16,805	29,366
Net income (loss)	3,192	(71)	(15,791)	9,300	19,331
Net income (loss) per share - basic	0.22	(0.01)	(1.18)	0.70	1.42
Net income (loss) per share - assuming dilution	0.22	(0.01)	(1.18)	0.68	1.39
Weighted average shares outstanding - basic	14,711	13,730	13,393	13,324	13,656
Weighted average shares outstanding - assuming dilution	14,831	13,730	13,393	13,583	13,907
Working capital	$ 59,946	$ 37,896	$ 61,979	$ 69,696	$ 74,061
Total assets	176,330	191,521	118,311	129,939	126,043
Stockholders' equity	127,164	121,251	95,471	109,943	105,827
Book value per share	8.52	8.34	7.09	8.24	7.82
Number of employees	583	703	481	698	605

(In thousands except per share amounts, percentages and number of employees)

To Our Stockholders

In July 1998, Digi completed the acquisition of two companies: ITK in Dortmund, Germany and Central Data in Champaign, Illinois. The strategy for fiscal 1999 was to enhance our seasoned serial port and LAN businesses and achieve significant market share in new high growth markets such as remote access and Internet telephony. The idea was to leverage the USB products of Central Data to spur sales in the serial port business and to exploit ITK's VoIP technology, allowing Digi to enter new high growth markets. Unusual circumstances dictated that this was not to be in fiscal 1999. Because of situations that emerged along the way, I would characterize fiscal 1999 as three distinct phases: change, stabilization and growth.

Phase I Change: By the onset of fiscal 1999, the process of integrating these entities into the Digi culture was in progress. The Central Data integration was moving along nicely, and by the end of January 1999, was virtually complete. However, at the end of the first quarter, the integration of ITK was still moving slowly and aggravated by the departure of essential ITK employees. Expenses in Europe were at extraordinary levels, and ITK was losing ground in the fields of ISDN and VoIP. This situation was further complicated by the abrupt resignation of our CEO, Jerry Dusa, and an SEC inquiry questioning the $39.2 million IPR&D write-off in connection with the acquisitions of Central Data and ITK. An ongoing IRS audit on the capitalization of R&D expenses for 1993, 1994 and 1995 added to the list of problems needing prompt attention.

Phase II stabilization: In early February, Kris Krishnan, Doug Glader and I formed a team to stabilize the situation and operate the company until a new CEO could be recruited. Gene Olsen was hired as Chief Technical Officer, and Jon Nyland took over as Vice President of Manufacturing Operations. The first mission was to complete the ITK integration, downsize the organization in Europe and, in general, reduce overall expenses. About the same time, it was discovered that our domestic distributor channel was at an uncomfortable inventory level, clearly an untenable situation. By the end of March 1999, the following was accomplished:

- ITK was integrated into Digi GmbH and expenses were under control. Head count was reduced, and redundant facilities were closed.
- The distributor sales channel inventory was lowered to below normal levels.

By the end of the third quarter, corporate expenses were back to traditional levels, and the SEC's IPR&D inquiry along with the IRS audit were negotiated and settled.

Phase III Growth: Next, the team's attention focused on product development. An essential part of Digi's ongoing business is dependent on the new DataFire RAS product line. Many important OEMs requested evaluation units and it was essential to ensure strong support from the company. To this end, a large segment of the engineering department was mobilized to provide fast corrective response to any defects these customers encountered. After several months of intense testing, companies like IBM took their first shipments of DataFire in September for deployment with their AS400s. Other customers for this product include Tropico (the Brazilian telephone company) and the South African Telco, a clear validation of our technology.

By fiscal year-end, our Sunnyvale operation was stabilized. All of Digi's European operations were consolidated into one company, Digi GmbH headquartered in Dortmund, Germany. The engineering team, located in Dortmund, upgraded the Netblazer 8500, which has led to increased sales activity for the ISDN and VoIP products. These are all positive signs for the future.

FINANCIAL ACCOMPLISHMENTS: At the beginning of February 1999, cash was at about $5 million and Digi's stock was about $6 per share. On September 30, cash exceeded $34 million and the stock was at about $14 per share, a definitive increase in shareholder value. Despite a tumultuous year, revenue grew 6 percent. Earnings were somewhat distorted due to the amortization costs associated with the two acquisitions and the resulting high effective tax rate. However, our operating income is a strong indicator of our success. These results leave the company well-positioned financially going forward.

The real strength of Digi International lies in the accomplishments of our employees. Their talent and commitment are vital to our future. During this period, our middle management stepped up to handle some difficult tasks. Special thanks go to Bill Lohse, Brian O'Rourke and Joe Toste. Clearly, the company has demonstrated that it can recover from the most adverse circumstances and emerge stronger and more confident to take on the future. Also, we thank Willis Drake, who is stepping down from the board of directors, for his many years of service and his contributions to Digi.

With our newly elected CEO Joe Dunsmore at the helm, I am confident that our company is in capable hands. Joe brings the market experience and determination to accelerate the growth of Digi International.

John P. Schinas
December 10, 1999

Joe Dunsmore Newly named CEO

"I watched Digi for nine months before coming on board. This company plays in a large and dynamic industry. There are no limits to our opportunities. What I think I can add is defining which track to take for growth, followed by solid execution. To do that, I'm spending the first 90 days on the road with our sales people and customers. At this point, I know we will leverage our experience in the small to medium-size business segment, and I'm excited about what we're pursuing in the open server and remote access markets."

Dunsmore's prior industry experience includes 17 years in executive management, product management, marketing positions and operations management at Lucent Microelectronics, 3Com and AT&T Paradyne.

[TECHNOLOGY. Digi's new communications products pack unprecedented connectivity into a standards-based server, handling functions once performed by separate modems and CSU/DSUs. Digi's DataFire family of digital adapters provides the widest compatibility and most powerful performance available, concentrating eight to 60 channels in a single PCI or CompactPCI slot, while supporting up to ISDN and T1/E1 connections. AccelePort RAS multi-modem adapters integrate four or eight channels in a single PCI slot at analog speeds to 56 Kbps/V.90+. Both product lines use digital signal processor (DSP) technology, resulting in the industry's highest density of on-board modems for a RAS concentrator.]

With the explosion of digital commerce, computer networks are fundamental to business every day, and those networks are increasingly built from standard components from multiple vendors. The rate of change of these systems to serve Internet and e-business initiatives demands distributed, modular and interoperable components. These market needs have not only validated the concept of server-based solutions, but have vastly broadened the available applications for them.

[Our products are the leading brand choice within our distribution channel.]

Digi has the products and partnerships to succeed in this environment. For example, our DataFire product line is the most advanced communications adapter for Windows NT communications applications. Server-based communications have grown from simple multiuser connections ... to bulletin board systems...to remote access servers. Today, server-based systems support enterprise-wide and carrier-class communications systems. And these applications span all market categories in such capacities as Internet gateways, intranets, extranets, sales force automation, customer relationship management, call centers and unified messaging.

[Chart. Digi's Digital Server-Based Market Share is 32%, Source: International Data Corporation, 1998.]

Open, server-based systems continue to prevail over closed proprietary systems due to their lower costs of ownership. In fact, Gartner Group recently said, "By 2005 only a few vendors will manufacture non-server-based products." Our open systems focus has allowed Digi to build and maintain long-term relationships with OEMs like Compaq, IBM and others, and operating systems vendors such as Microsoft, Novell and most recently, Red Hat. Value-added resellers (VARs) traditionally prefer open systems solutions -- when functionality is equal -- because it means they don't need trained experts on multiple proprietary technologies.

Although networks are increasingly employing digital transmission technology, the majority still use analog phone lines. Our AccelePort products continue to be the leading choice for these users. DataFire products then provide an upgrade path to digital applications and round out a complete product portfolio to establish Digi as the leading vendor in this market. Standards-based systems are more readily networked. And networked systems allow the convergence of business applications.

Microsoft has played a pivotal role in driving the server-based market, by embedding advanced services into its Windows operating system. With the advent of Windows 2000, capability and robustness have advanced. This includes telephony services, and also vital technologies such as directory services. These developments enable converged applications between products of different vendors, and they permit smaller scale networks to enjoy the same capabilities previously only available to large networks.

[Our open systems focus has allowed Digi to build and maintain long-term relationships with OEMs.]

[Chart]

Year	Dollars
'98	338
'99	427
'00	532
'01	637
'02	750

Worldwide Server-Based
RAS Market, 1998-2000
(estimated end-user revenues
in millions)
source: International Data Corporation, 1998

Digi International has supported Windows networks from the very beginning, and this means that Digi products are installed in more Windows Routing and Remote Access Services (RRAS) installations worldwide than any other vendor. As these Windows systems take on new tasks, DataFire adapters are one of the most trusted and familiar brands among network installers.

[NEW MARKETS. With data and voice traffic converging at the network server, Digi will emerge as a premier provider of server-based computer telephony applications. To date, the computer telephony industry has been dominated by proprietary solutions. The combined calendar year 2000 RAS and computer telephony integration (CTI) markets represent an estimated $1.2 billion opportunity, growing at 32 percent annually. The open systems RAS adapter market is estimated to reach $750 million in 2002, while the market for multi-function, open systems CTI adapters, as measured by Frost and Sullivan, is expected to top $2 billion by 2004.]

[PARTNERS. Digi is the only vendor providing both digital and analog products for remote access connectivity using RAS in Windows 2000. Users can quickly configure Digi's products by clicking on the Digi icon in Windonws' Add New Hardware Wizard, a new feature of Windows 2000. Digi's AccelePort products are the first products of their kind to be listed under the Wizard's Serial Port Device Class. "Communications, including remote access, is a critical, growing market that Windows NT addresses today very effectively, and this offering gets even more compelling for customers in Windows 2000, said Mark Lee, product manager of Windows Communications, Microsoft Corporation.]

Small and medium-size businesses comprise more than 98 percent of all business enterprises in the world, and these organizations are rapidly installing networks. These customers do not, as a rule, have IT departments or large computing budgets. Therefore, they require solutions on a smaller scale -- though with many of the same functions as larger systems -- that they can begin using immediately. According to International Data Corporation, "By 2000, entry servers will grow to be larger than the combined mid-range and high-end server markets. It is essential for all global server vendors to have a strong commitment to this critical segment of the market."

[Digi's commitment is to provide the finest communications interface for leading standards-based server systems.]

Digi has served small and medium applications for almost 15 years -- so Digi's reputation for support and ease-of-use is firmly established. This is an enviable position against competitors who only understand the needs of very large networks. We fully intend to leverage this advantage and our experience.

One of the key new technologies is computer telephony integration (CTI) - -- the merging of data and phone networks. CTI will drive sales of IT equipment to new heights, as the benefits of automating elements of customer service become apparent. Digi's advanced development in this field has achieved design wins with major technology partners and made us a viable player in telecommunications carrier markets as well as corporate computing environments.

The success of open-systems standards has affected competition in a variety of ways. Application developers can count on a consistent set of operating systems services, and concentrate on providing the most innovative solutions to business problems. This benefits users, because they can select from "best-of-breed" products in each product category, and it benefits

Digi, since we can dedicate ourselves to providing functions to operating systems and applications instead of developing the applications ourselves. This focus on "core competency" allows Digi to maintain a market leadership position in remote access markets and expand that specialization expertise across a wide range of vertical markets.

[Digi products are installed in more RRAS installations worldwide than any other vendor.]

[Chart]

Year	Dollars
'99	94.2
'00	181.2
'01	344.6
'02	601.1
'03	1,043
'04	2,000

Server-Based CTI Adapter
U.S. Market Growth (estimated, in millions)
source: Frost and Sullivan

Digi recognizes -- and, in fact, it is the hallmark of open systems -- that customers will decide what is the best product for their particular needs. Digi's commitment to the market is to provide the finest communications interface for the leading standards-based server systems. This is possible because Digi can focus on interfacing with the most popular operating environments, and supporting the communications services and protocols that ~enable converged applications.

For example, our adoption of digital signal processor (DSP) technology provides a highly versatile platform, allowing a single engineering group to program added value into multiple product lines. It also allows Digi to support the latest communication devices like 56K modems and the foundation to support the advanced UNIX operating environments like Sun Solaris, IBM AIX and HP/UX, as well as open source software like Linux.

Digi's emphasis on supplying best-of-breed solutions has aligned us with market drivers like Microsoft, Sun, Intel and Linux. Our products are the leading brand choice within our distribution channel, known for their quality, versatility and ease of integration. The result: Digi is well-positioned to dominate our niche in the growing open systems, server-based market.

[OPPORTUNITY. Digi's products currently sell strongest in small and medium enterprises (SMEs), and chiefly among analog multiuser and analog RAS applications. Due to the abundance and low cost of analog connections, digital connections for the emerging SMEs are still in the very early stages but represent a tremendous growth opportunity. In the United States alone, there are over 9.2 million SME organizations. One of the most significant markets for these products is Microsoft Windows NT and 2000, where Digi leads analog connections. This leadership, coupled with a new state-of-the-art product line, means there are few vendors as well-positioned as Digi to dominate the SME segment.]

DIRECTORS AND OFFICERS

DIRECTORS

JOHN P. SCHINAS (3)
Mr. Schinas is a founder of the Company and has been its Chairman of the Board since July 1991. He has been a member of the Board of Directors since the Company's inception in July 1985 and served as the Company's CEO from July 1985 to January 1992 and interim CEO from February to October 1999.

JOSEPH T. DUNSMORE
Mr. Dunsmore has been a member of the Board of Directors and President and Chief Executive Officer of the Company since October 24, 1999. Mr. Dunsmore has more than 17 years' experience in the data communications and telecommunications industries and has held executive management positions in a number of companies including Paradyne, AT&T Paradyne, U.S. Robotics, 3Com and, most recently, Lucent Technologies, where he served as Vice President of Access in the Microelectronics Group.

WILLIS K. DRAKE (2)
Mr. Drake has been a member of the Board of Directors since 1987 and a private investor since 1983.

RICHARD E. EICHHORN (2)(3)
Mr. Eichhorn has been a member of the Board of Directors since 1987. Since April 1992, Mr. Eichhorn has been a private investor.

KENNETH E. MILLARD (2)
Mr. Millard has been a member of the Board of Directors since October 1999. He has been the President and COO of Telular Corp., a tele-communications company, since April 1996. Mr. Millard has held various executive management positions in the telecommunications industry and worked as an attorney for AT&T and Wisconsin Bell. Mr. Millard continues to serve as a director of Telular and also serves as a director of Omnitech, a private corporation.

ROBERT S. MOE (1)(2)
Mr. Moe has been a member of the Board of Directors since October 1996. From 1981 to his retirement in 1993, he was the Chief Financial Officer of Polaris Industries, a manufacturer of snowmobiles, all-terrain vehicles and personal watercraft.

MYKOLA MOROZ (1)
Mr. Moroz has been a member of the Board of Directors since July 1991. Mr. Moroz was a founder of the Company and CEO from January 1992 to September 1994. Mr. Moroz was Chief Operating Officer of the Company from July 1991 to January 1992. From October 1985 to July 1991, he occupied various management positions with the Company. He is now a private consultant.

DAVID STANLEY (1)(3)
Mr. Stanley has been a member of the Board of Directors since 1990. Mr. Stanley is the retired Chairman and CEO of Payless Cashways, Inc., a building materials retailer.

(1) Audit Committee
(2) Compensation Committee
(3) Corporate Governance and Nominating Committee

EXECUTIVE OFFICERS

JOSEPH T. DUNSMORE
President and Chief Executive Officer

DOUGLAS J. GLADER
Executive Vice President and Chief Operating Officer

SUBRAMANIAN KRISHNAN
Senior Vice President and Chief Financial Officer

CORPORATE SECRETARY

JAMES E. NICHOLSON
Partner, Faegre & Benson LLP

CORPORATE GOVERNANCE

The majority of the Board's membership is comprised of non-employee directors.

The compensation and audit committees are comprised of all non-employee directors.

The positions of Chairman of the Board and Chief Executive Officer are separate.

STOCKHOLDER AND INVESTOR INFORMATION

STOCK LISTING The Company's Common Stock trades on the Nasdaq National Market tier of the Nasdaq Stock Market(TM) under the symbol "DGII." At December 10, 1999, the number of holders of the Company's Common Stock was approximately 8,028 consisting of 356 record holders and approximately 7,672 stockholders whose stock is held by a bank, broker or other nominee.

High and low sale prices for each quarter during the years ended September 30, 1999 and 1998, as reported on the Nasdaq Stock Market, were as follows:

STOCK PRICES

1999	FIRST	SECOND	THIRD	FOURTH
High	$16.38	$11.75	$11.00	$13.50
Low	$ 8.56	$ 6.25	$ 6.25	$ 9.88
1998	FIRST	SECOND	THIRD	FOURTH
High	$22.75	$28.62	$29.50	$28.25
Low	$13.75	$17.00	$19.50	$ 9.62

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 foresable future.

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

STOCKHOLDER INFORMATION
Transfer Agent and Registrar
Norwest Bank Minnesota, N.A.
Norwest Shareowners Services
P.O. Box 64864
St. Paul, MN 55164-0854
651-450-4004
800-468-9716

Legal Counsel
Faegre & Benson LLP
2700 Norwest Center
Minneapolis, MN 55402-3901

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

Annual Meeting
The Company's Annual Meeting of Stockholders will be held on Wednesday, January 26, 2000, at 3:30 p.m., at the Marquette Hotel, 710 Marquette Avenue, Minneapolis, Minnesota.

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

Investor Relations Administration
Digi International Inc.
11001 Brew Road Last
Minnetonka, MN 55343
or call 612-912-DIGI
e-mail request to ir@digi.com

CORPORATE OFFICE

Digi International
11001 Bren Road East
Minnetonka, MN 55343
TEL: 612-912-3444
FAX: 612-912-4991

NORTH AMERICAN SALES OFFICES

Digi International
11001 Bren Road East
Minnetonka, MN 55343
TEL: 800-344-4273, 612-912-3444
FAX: 612-912-4952

Digi International
1299 Orleans Drive
Sunnyvale, CA 94089
TEL: 800-466-4526
FAX: 408-744-2793

Digi International
Government Systems
10000 Falls Road, Suite 203
Potomac, MD 20854
TEL: 301-983-4699
FAX: 301-983-4542

INTERNATIONAL OFFICES

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Joseph-von-Fraunhofer n Str. 23
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Digi International Limited
Knightway House
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FAX: +44-1276-453-674

Digi International Sarl
2 rue de L'Eglise
92200 Neuilly sur Seine
France
TEL: +33-1-55-61-98-98
FAX: +33-1-55-61-98-99

Digi International Australia Pty. Ltd.
Unit 10, 10 Gladstone Street
Castle Hill, NSW 2154
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FAX: +61-2-9680-9178

Digi International N.V.
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1015 CS Amsterdam,
The Netherlands
TEL: +31-20-5207-556
FAX: +31-20-5207-972

Digi International Denmark
Hejreskovvej 18C 1.9.8
DK-3490 Kvistgaard, Denmark
TEL: +45-49-17-70
FAX: +45-49-17-70-91

Digi International Asia Pte Ltd.
13 06 Lower 'A', 391A Orchard Road,
Ngee Ann City, Singapore 238837
TEL: +65-732-1318
FAX: +65-732-1312

Digi International (HK) Limited
Suite 1101-02, 11/F
K Wah Centre
191 Java Road
North Point
Hong Kong
TEL: +852-2833-1008
FAX: +852-2572-9989

DIGI INTERNATIONAL INC.
11001 Bren Road East
Minnetonka, MN 55343
TEL: 612-912-3444
FAX: 612-912-4991 (central fax)
nasdaq national market; DGII
www address: www.digi.com
e-mail address: info@digi.com

EXHIBIT 21

SUBSIDIARIES OF THE COMPANY

Digi International Asia Pte Ltd

Digi International GmbH

Digi International FSC

Digi International (HK) Ltd.

Digi International Australia PTY Ltd.

Digi International Limited

Digi International SARL

ITK International, Inc.

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the Form S-8 registration statements of Digi International Inc. for its Stock Option Plan (File No. 33-32956, File No. 33-38898, File No. 333-99 and File No. 333-23857); for its Employee Stock Purchase Plan (File No. 333-1821); and for its Non-Officer Stock Option Plan (File No. 33-57869) of our report dated December 15, 1999, on our audits of the consolidated financial statements of Digi International Inc. as of September 30, 1999 and 1998, and for the years ended September 30, 1999, 1998 and 1997, which report is included in or incorporated by reference in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP

Minneapolis, Minnesota
December 27, 1999

EXHIBIT 23.2

Consent of Independent Auditors

We consent to the incorporation by reference in the Form S-8 Registration Statements (File No. 33-32956, File No. 33-38898, File No. 333-99 and File No. 333-23857) of Digi International Inc. for its Stock Option Plan; Form S-8 Registration Statement (File No. 333-1821) of Digi International Inc. for its Employee Stock Purchase Plan and Form S-8 Registration Statement (File No. 33-57869) of Digi International Inc. for its Non-Officer Stock Option Plan of our report dated October 28, 1997, with respect to the financial statements of AetherWorks Corporation for the years ended September 30, 1997 and 1996, and the period from February 24, 1993 (inception) to September 30, 1997, included in the Annual Report (Form 10-K) of Digi International Inc. for the fiscal year ended September 30, 1999 filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
December 28, 1999

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 10th of December, 1999.

/s/ John P. Schinas

John P. Schinas

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint John P. Schinas, Joseph T. Dunsmore and Subramanian Krishnan, and any 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 any 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 10th of December, 1999.

/s/ Robert S. Moe

Robert S. Moe

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint John P. Schinas, Joseph T. Dunsmore and Subramanian Krishnan, and any 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 any 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 10th of December, 1999.

/s/ Willis K. Drake

Willis K. Drake

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

The undersigned director and/or officer of Digi International Inc., a Delaware corporation, does hereby make, constitute and appoint John P. Schinas, Joseph T. Dunsmore and Subramanian Krishnan, and any 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 any 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 10th of December, 1999.

/s/ David Stanley

David Stanley

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 10th of December, 1999.

/s/ Richard E. Eichhorn

Richard E. Eichhorn

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 10th of December, 1999.

/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 John P. Schinas, Joseph T. Dunsmore and Subramanian Krishnan, and any 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 any 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 10th of December, 1999.

/s/ Kenneth Millard

Kenneth Millard

DIGI INTERNATIONAL INC.

Power of Attorney
of Director and/or Officer

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IN WITNESS WHEREOF, the undersigned has hereunto set the undersigned's hand this 10th of December, 1999.

/s/ Joseph T. Dunsmore

Joseph T. Dunsmore

5
1
USD

YEAR
SEP-30-1999
OCT-01-1998
SEP-30-1999
1
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0.22