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

FORM 10-Q

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

For the quarterly period ended: March 31, 2002.

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)

(952) 912-3444

(Registrant's telephone number, including area code)

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

Yes X No ____

On May 10, 2002, there were 22,176,877 shares of the registrant's $.01 par value Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
FOR THREE MONTHS AND SIX MONTHS ENDED MARCH 31, 2002 AND 2001
(UNAUDITED)

	Three months ended March 31		Six months ended March 31	
	2002	2001	2002	2001
Net sales	$ 25,192,717	$32,065,121	$ 50,342,879	$67,023,341
Cost of sales	12,019,152	15,373,061	23,719,455	31,897,213
Gross margin	13,173,565	16,692,060	26,623,424	35,126,128
Operating expenses:				
Sales and marketing	7,804,216	7,979,625	14,501,513	15,252,603
Research and development	4,827,941	5,049,909	8,553,589	9,607,932
General and administrative	4,643,095	3,620,756	8,832,367	8,413,114
Acquired in-process research and development	3,100,000	—	3,100,000	—
Loss on sale of MiLAN assets	3,616,645	—	3,616,645	—
Restructuring	—	(47,731)	—	(229,769)
Total operating expenses	23,991,897	16,602,559	38,604,114	33,043,880
Operating (loss) income	(10,818,332)	89,501	(11,980,690)	2,082,248
Other income, net	103,943	491,706	449,367	1,480,333
(Loss) income before income taxes and cumulative effect of accounting change	(10,714,389)	581,207	(11,531,323)	3,562,581
Income tax (benefit) provision	(3,379,588)	261,091	(3,690,023)	1,751,778
(Loss) income before cumulative effect of accounting change	(7,334,801)	320,116	(7,841,300)	1,810,803
Cumulative effect of accounting change (net of income tax benefit of $1,055,928)		—		(1,901,853)
Net (loss) income	$ (7,334,801)	$ 320,116	$ (7,841,300)	$ (91,050)
Net (loss) income per common share, basic:				
Continuing operations	$ (0.39)	$ 0.02	$ (0.46)	$ 0.12
Cumulative effect of accounting change	—	—	$ —	$ (0.13)
	$ (0.39)	$ 0.02	$ (0.46)	$ (0.01)
Net (loss) income per common share, assuming dilution:				
Continuing operations	$ (0.39)	$ 0.02	$ (0.46)	$ 0.12
Cumulative effect of accounting change	—	—	$ —	$ (0.13)
	$ (0.39)	$ 0.02	$ (0.46)	$ (0.01)
Weighted average common shares, basic	18,924,732	15,207,896	17,124,443	15,187,269
Weighted average common shares, assuming dilution	18,924,732	15,215,892	17,124,443	15,199,649

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

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
AS OF MARCH 31, 2002 AND SEPTEMBER 30, 2001

ASSETS	March 31 2002	September 30 2001
	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 37,866,287	$ 30,347,253
Marketable securities	14,973,457	25,804,947
Accounts receivable, net	11,056,726	16,161,143
Inventories, net	16,000,784	16,791,851
Other	5,583,748	4,602,668
Total current assets	85,481,002	93,707,862
Property, equipment and improvements, net	22,098,430	22,677,155
Goodwill, net	46,438,784	10,521,157
Identifiable intangible assets, net	28,262,117	11,017,233
Other	1,397,281	1,529,169
Total assets	$183,677,614	$139,452,576
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Borrowings under line of credit agreements	$ 522,600	$ 938,400
Current portion of long-term debt	318,284	1,584,156
Accounts payable	7,322,743	6,012,296
Income taxes payable	46,885	—
Accrued expenses:		
Advertising	771,985	856,939
Compensation	5,309,207	3,317,935
Other	8,165,520	5,395,249
Restructuring reserves	44,607	1,369,799
Total current liabilities	22,501,831	19,474,774
Long-term debt	5,074,051	5,499,226
Net deferred income taxes	120,883	1,561,155
Total liabilities	27,696,765	26,535,155
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 60,000,000 shares authorized; 23,152,255 and 16,425,606 shares issued and outstanding	231,523	164,256
Additional paid-in capital	121,227,452	71,458,733
Retained earnings	51,785,257	59,626,557
Accumulated other comprehensive income	207,391	7,969
	173,451,623	131,257,515
Unearned stock compensation	(517,505)	—
Treasury stock, at cost, 1,013,036 and 1,095,881 shares	(16,953,269)	(18,340,094)
Total stockholders' equity	155,980,849	112,917,421
Total liabilities and stockholders' equity	$183,677,614	$139,452,576

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

DIGI INTERNATIONAL INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED MARCH 31, 2002 AND 2001
(UNAUDITED)

	2002	2001
Operating activities:		
Net loss	$ (7,841,300)	$ (91,050)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Acquired in-process research and development	3,100,000	—
Loss on sale of MiLAN assets	3,616,645	—
Restructuring	—	(229,769)
Depreciation of property and equipment	1,559,905	2,204,551
Amortization of intangibles	3,511,227	2,594,528
Provision for losses on accounts receivable	(22,985)	215,024
Provision for inventory obsolescence	496,000	365,000
Loss (gain) on sale of fixed assets	7,545	(1,315)
Stock compensation	26,314	57,278
Changes in operating assets and liabilities	(1,921,604)	(1,641,440)
Total adjustments	10,373,047	3,563,857
Net cash provided by operating activities	2,531,747	3,472,807
Investing activities:		
Sale (purchase) of held-to-maturity marketable securities, net	10,831,490	(13,955,123)
Proceeds from sale of MiLAN assets	8,058,932	—
Business acquisition, net of cash acquired	(10,418,955)	(7,236,422)
Contingent purchase price payments related to business acquisitions	(1,998,577)	—
Purchase of property, equipment, intangibles and improvements	(341,234)	(611,669)
Net cash provided by (used in) investing activities	6,131,656	(21,803,214)
Financing activities:		
Payments under line of credit agreements	(374,832)	(462,200)
Principal payments on long-term debt	(1,355,213)	(330,691)
Stock benefit plan transactions	385,112	533,461
Net cash used in financing activities	(1,344,933)	(259,430)
Effect of exchange rate changes on cash and cash equivalents	200,564	23,362
Net increase (decrease) in cash and cash equivalents	7,519,034	(18,566,475)
Cash and cash equivalents, beginning of period	30,347,253	38,785,936
Cash and cash equivalents, end of period	$ 37,866,287	$ 20,219,461

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

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

1. BASIS OF PRESENTATION

The interim condensed consolidated financial statements included in this Form 10-Q have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted, pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in the Company's 2001 Annual Report on Form 10-K.

The condensed consolidated financial statements presented herein as of March 31, 2002, and for the three and six months ended March 31, 2002 and 2001, reflect, in the opinion of management, all adjustments (which consist only of normal, recurring adjustments) necessary for a fair presentation of the consolidated financial position and the consolidated results of operations and cash flows for the periods presented. The consolidated results of operations for any interim period are not necessarily indicative of results for the full year.

2. ACQUISITIONS

On February 13, 2002, the Company acquired NetSilicon, Inc. (NetSilicon), a provider of Ethernet micro-processing solutions for intelligent, networked devices for a purchase price of $67,153,231. The transaction was accounting for using the purchase method of accounting. Accordingly, the purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed.

The Company's acquisition was made principally due to the complementary nature of the two companies' device connectivity products, which would give the Company an expanded range of products and technology and allow the Company to be an early entrant in the embedded system market.

The purchase consideration, and related transaction costs, includes $16,315,532 in cash, Digi's common stock with a market value of $41,732,231, and replacement stock options issued by Digi to certain NetSilicon common stock option holders with an estimated fair value of $9,105,468. The cash and Digi's common stock were issued in exchange for all outstanding shares of NetSilicon's common stock and Digi's common stock options were issued in exchange for certain outstanding NetSilicon common stock options. The value of the Digi common stock was based on a per share value of approximately $6.21, calculated as the average market price of Digi's common stock during the five business days immediately preceding and subsequent to the date the parties reached agreement on terms and announced the proposed acquisition. The value of Digi's common stock options is based on the estimated fair value of these options, as of the date the transaction was announced, using the Black-Scholes valuation model. Unearned compensation of $543,819 has been recorded related to the intrinsic value of the unvested replacement common stock options for which future services are required before the option holders vest in the replacement options.

2. ACQUISITIONS (CONTINUED)

The table below sets forth the purchase price allocation.

Cash	$15,000,098
Digi common stock (6,720,166 shares)	41,732,231
Estimated fair value of Digi stock options issued to replace stock options held by NetSilicon employees	9,105,468
Direct acquisition costs	1,315,434
	$67,153,231
Estimated fair value of tangible assets acquired	$ 5,596,438
Identifiable intangible assets	17,700,000
Acquired in-process research and development	3,100,000
Goodwill	39,115,974
Deferred compensation	543,819
Acquired deferred tax asset	8,000,000
Deferred tax liabilities related to identifiable intangibles	(6,903,000)
	$67,153,231

Statement of Financial Accounting Standards No. 141, “Business Combinations” specifies that goodwill relating to acquisitions occurring after June 30, 2001 is no longer amortized. Therefore, the results of operations for the three and six month periods ended March 31, 2002 do not include any goodwill amortization expense related to the NetSilicon acquisition. All other goodwill from previous acquisitions continues to be amortized as the Company will not adopt Statement of Financial Accounting Standards No. 142, “Goodwill and Intangible Assets” until October 1, 2002.

At the time of acquisition, NetSilicon had two development projects in process, the Net + 20 chip and the Net + OS v. 5.0. The Net + 20 project involved the creation of a chip that has strong functionality, but can be sold very inexpensively. The Net + OS v. 5.0 relates to the creation of an operating system that has increased functionality, especially in the areas of security and management. The new technology being utilized to develop a lower priced chip and the new technology to create an operating system with increased functionality differed significantly from previous projects due to the challenges of building a chip in the lower price range and differences in technology in the predecessor operating system that is currently being sold. Accordingly, the Company was uncertain whether the technology being developed could become commercially viable. 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 $3.1 million of the purchase price represents the fair value of purchased in-process research and development related to the Net + 20 chip and the Net + OS v. 5.0 operating system referred to above, that had not yet reached technological feasibility and had no alternative future uses. This amount was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition.

2. ACQUISITIONS (CONTINUED)

The Company utilized the 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 NetSilicon’s estimate of top-line revenue growth over the next four fiscal years, primarily from the revenue growth of the Net + 50 and the Net + 20 chips.

- The estimated gross margin is based upon historical gross margin for NetSilicon’s products, which include chips, boards, and development kits. Average gross margin is approximately 57.5%.

- The estimated selling, general and administrative expenses for NetSilicon are projected to decrease as a percent of sales.

- The discount rate used 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 discount rate used in the alternative valuation approach was 18.0%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The following rates of return were used for the in-process research and development products:

Net + 20	35%
Net + OS v. 5.0	30%

Management estimates that the projects will be complete within the next year. Management has also estimated that the remaining completion costs (primarily research and development expenses) is approximately $1,023,000. 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.

In June 2001, the Company acquired INXTECH, the parent company of Decision Europe, a French designer and manufacturer of data communications systems sold under the Xcell Technology brand. The transaction was accounted for using the purchase method of accounting. Accordingly, the initial purchase price of $2,424,095 was allocated to the estimated fair value of assets acquired and liabilities assumed.

In March, 2002, the Company paid an additional $600,000 relating to the INXTECH acquisition and the Company may be required to pay up to $1,900,000 of additional cash consideration for the purchase subject to Decision Europe achieving certain future product development milestones and retaining certain key employees during the three years following the acquisition.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. ACQUISITIONS (CONTINUED)

The following unaudited pro forma condensed consolidated results of operations have been prepared as if the acquisitions of INXTECH & Net Silicon had occurred as of the beginning of fiscal 2001:

	Three months ended March 31		Six months ended March 31	
	2002	2001	2002	2001
Net sales	$28,577,615	$40,944,489	$59,882,400	$86,040,837
Net loss	(5,676,917)	(2,526,633)	(9,691,791)	(4,167,121)
Net loss per share	$ (0.26)	$ (0.12)	$ (0.43)	$ (0.19)

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisitions occurred as of the beginning of fiscal 2001, nor are they necessarily indicative of the results that will be obtained in the future.

On October 2, 2000, the Company acquired Inside Out Networks (ION), a developer of data connections products based in Austin, Texas. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price of $7,684,000 million has been allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price consisted of an initial payment of $7,258,000 followed by contingent purchase payments in the amount of $426,000, which were made in fiscal 2001. In November 2001, the company paid an additional $1,399,000 million relating to the ION acquisition based upon the achievement of specific revenue and operating income targets specified in the purchase agreement.

The Company may pay up to $7,100,000 of additional cash consideration for the purchase subject to ION achieving specific revenue and operating income targets during the three years following the acquisition.

3. LOSS ON SALE OF MiLAN ASSETS

On March 25, 2002, the Company sold substantially all of the assets of its former MiLAN Technology division (MiLAN), to Communications Systems, Inc. (CSI) for $8,059,000, resulting in a pre tax loss of $3,617,000 ($3,107,000 net of taxes). Included in the net loss on this transaction is $908,000 of severance costs related to certain former employees of MiLAN.

4. RESTRUCTURING

In September 2001, the Company implemented a restructuring plan that resulted in a workforce reduction of 50 employees in Minnetonka, MN and 11 employees in Sunnyvale, California. A charge of $1,351,870 was recorded for severance and outplacement costs. As of March 31, 2002, $1,320,454 has been paid.

In September 2000 the Company’s Board of Directors approved a restructuring plan related to its European operations headquartered in Dortmund, Germany, which provided for the transition of all product development, technical support and manufacturing functions to the Company’s corporate headquarters located in Minnetonka, Minnesota. The plan also included the closure of the Company’s office in Bagshot, England. The resulting charge of $1,531,992 consisted of $1,252,531 for severance and

4. RESTRUCTURING (CONTINUED)

termination costs related to the elimination of 73 positions in Dortmund, Germany and 2 positions in Bagshot, England; $134,227 related to the closure of the Bagshot office for lease cancellation; $100,684 of cancellation fees related to automobile leases, maintenance contracts, and office equipment leases, and $44,550 for severance-related legal expenses. As of September 30, 2001, the Company had paid $1,079,321 of severance and termination costs relating to the elimination of the 69 positions. During the six months ended March 31, 2002, the Company paid $4,738 relating to the remaining contractual payments.

The Company's restructuring activities are summarized as follows:

Description	Balance at September 30, 2001	Payments	Change in Estimate Adjustments	Balance at March 31, 2002
September 2001 Restructuring Plan:				
- Severance and termination costs	$1,351,870	$(1,320,454)		$31,416
Subtotal	1,351,870	(1,320,454)		31,416
September 2000 European Restructuring Plan:				
- Contractual payments	17,929	(4,738)		13,191
Subtotal	17,929	(4,738)	—	13,191
Totals	$1,369,799	$(1,325,192)	$ —	$44,607

5. INVENTORIES

Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out method. Inventories at March 31, 2002 and September 30, 2001 consisted of the following:

	March 31, 2002	Sept. 30, 2001
Raw materials	$12,332,830	$11,480,340
Work in process	914,515	664,055
Finished goods	2,753,439	4,647,456
	$16,000,784	$16,791,851

6. SEGMENT INFORMATION

Prior to the acquisition of NetSilicon as described in Note 2, the Company operated in a single reportable segment. With the acquisition of NetSilicon, the Company now operates in two reportable segments.

The reportable segments the Company operates in include the following:

Connectivity Solutions — Connectivity Solutions are used by businesses to create, customize and control retail operations, industrial automation and other applications. The primary product lines include multi-port serial adapters, device servers, terminal servers, and Universal Serial Bus (USB) connectivity. Included in this segment are the Company's Growth, Mature, and MiLAN product lines. The Company's Connectivity Solutions segment has operating facilities located in Minnetonka, Minnesota; Sunnyvale, California; Austin, Texas, Torrance California (Inside Out Networks); Les Lucs, France (Decision Europe); and Dortmund, Germany. The Company no longer occupies the Sunnyvale, California facility as a result of the sale of the assets of the MiLAN division.

Embedded Networking Solutions — Embedded Networking Solutions are integrated hardware and software for manufacturers who want to build network-ready products. This family of solutions integrates network-enabled microprocessors (specialized computer chips), an operating system, networking software, development tools, and a high level of technical support. The primary product lines include integrated semiconductor and controller products. In addition, the Company licenses software products that are embedded into intelligent electronic devices to enable Internet and Web-based communications. The operations for NetSilicon comprise this segment. NetSilicon is located in Waltham, Massachusetts.

6. SEGMENT INFORMATION (CONTINUED)

Summary financial data by business segment is presented below:

(In thousands)	Three months ended March 31, 2002		
	Connectivity Solutions	Embedded Networking Solutions	Total
Net sales	21,856	3,337	25,193
Operating loss	(6,243)	(4,575)	(10,818)
Total assets	114,523	69,155	183,678

(In thousands)	Six months ended March 31, 2002		
	Connectivity Solutions	Embedded Networking Solutions	Total
Net sales	47,006	3,337	50,343
Operating loss	(7,406)	(4,575)	(11,981)
Total assets	114,523	69,155	183,678

The Embedded Networking Solutions segment operating results for the three and six month periods ended March 31, 2002 are the same since the acquisition of NetSilicon, which comprises the Company's Embedded Networking Solutions segment, occurred during the three months ended March 31, 2002.

6. SEGMENT INFORMATION (CONTINUED)

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

(In thousands)	Three months ended March 31 2002	Three months ended March 31 2001	Six months ended March 31 2002	Six months ended March 31 2001
Operating (loss) income — Connectivity Solutions	$ (6,243)	$ 89	$ (7,406)	$2,082
Operating loss — Embedded Networking Solutions	(4,575)	—	(4,575)	—
	(10,818)	89	(11,981)	2,082
Other income, net	104	492	450	1,481
Consolidated (loss) income before income taxes and cumulative effect of accounting change	$(10,714)	$581	$(11,531)	$3,563

7. COMPREHENSIVE (LOSS) INCOME

The components of total comprehensive (loss) income are shown below. Comprehensive (loss) income includes net (loss) income and foreign currency translation adjustments that are charged or credited to stockholders’ equity.

Comprehensive (loss) income for the three months and six months ended March 31, 2002 and 2001 was as follows:

	Three months ended March 31		Six months ended March 31	
	2002	2001	2002	2001
Net (loss) income	$(7,334,801)	$320,116	$(7,841,300)	$ (91,050)
Foreign currency translation adjustments	93,105	114,637	199,422	(352,805)
Comprehensive (loss) income	$(7,241,696)	$434,753	$(7,641,878)	$(443,855)

8. NET (LOSS) INCOME PER SHARE

Basic net (loss) income per share is calculated based on the weighted average of common shares outstanding during the period. Net (loss) income per share, assuming dilution, is computed by dividing net (loss) income by the weighted average number of common and common equivalent shares outstanding. The Company's only common equivalent shares are those that result from dilutive common stock options.

The following table is a reconciliation of the numerators and denominators in the (loss) income per share calculations:

	Three months ended March 31			Six months ended March 31		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
2002						
Basic loss per share						
Loss available to common stockholders	$(7,334,801)	18,924,732	$(0.39)	$(7,841,300)	17,124,443	$(0.46)
Effect of dilutive securities						
Common equivalent shares	—	—	—	—	—	—
Diluted loss per share						
Net loss available to common stockholders	$(7,334,801)	18,924,732	$(0.39)	$(7,841,300)	17,124,443	$(0.46)
2001						
Basic income per share						
Net income (loss) available to common stockholders	$ 320,116	15,207,896	$ 0.02	$ (91,050)	15,187,269	$(0.01)
Effect of dilutive securities						
Common equivalent shares	—	7,996	—	—	12,380	—
Diluted loss per share						
Net income (loss) available to common stockholders	$ 320,116	15,215,892	$ 0.02	$ (91,050)	15,199,649	$(0.01)

Common equivalent shares of 191,206 and 113,260 for the three and six month periods ended March 31, 2002 resulting from common stock options were not included in the computation of diluted earnings per share because their effect is antidilutive.

Options to purchase 4,642,469 and 5,158,974 shares for the three and six month periods ended March 31, 2002, and options to purchase 2,720,657 and 2,582,871 shares for the three and six month periods ended March 31, 2001, were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of common shares.

Pursuant to Statement of Financial Accounting Standards No. 128 "Earnings per Share", loss before cumulative effect of accounting change has been used in determining diluted earnings per share for the six months ended March 31, 2001.

9. RECENT ACCOUNTING DEVELOPMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141, “Business Combinations” (FAS 141), and No. 142, “Goodwill and Other Intangible Assets” (FAS 142). The most significant changes made by FAS No. 141 are: 1) requiring that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and 2) establishing specific criteria for the recognition of intangible assets separately from goodwill. FAS No. 142 primarily addresses the accounting for acquired goodwill and intangible assets (i.e., the post- acquisition accounting). The Company will adopt the provisions of FAS No. 142 at the beginning of fiscal year 2003. However, the transition provisions of FAS No. 142 do apply to the Company’s accounting for the NetSilicon acquisition as this acquisition occurred after June 30, 2001. The most significant changes made by FAS No. 142 are: 1) goodwill and indefinite-lived intangible assets will no longer be amortized, and 2) goodwill and indefinite-lived intangible assets will be tested for impairment at least annually. Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the non-amortization and amortization provisions of this statement. These standards only permit prospective application of the new accounting; accordingly, adoption of these standards will not affect previously reported financial information of the Company. Although the Company has not completed its assessment of the impact of the adoption of FAS 142, management believes that the principal effect will be the Company ceasing the amortization of goodwill and assembled workforce. Goodwill and assembled workforce amortization was approximately $1,300,000 and $1,191,000 for the six months ended March 31, 2002 and 2001, respectively. Goodwill and assembled workforce amortization was approximately $2,427,000 for the year ended September 30, 2001.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143, “Accounting for Asset Retirement Obligations” (FAS 143), which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. FAS 143 requires an entity to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred. Upon initial recognition of a liability for an asset retirement obligation, an entity shall capitalize an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as the liability. FAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company has not completed its assessment of the impact of adoption of FAS 143.

In August 2001, the FASB issued FAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (FAS 144). This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets, except for goodwill and indefinite-lived intangible assets, which is addressed by FAS 142. FAS 144 retains and expands upon the fundamental provisions of existing guidance related to the recognition and measurement of the impairment of long-lived assets to be held and used and the measurement of long-lived assets to be disposed of by sale. Generally, the provisions of FAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001 (fiscal 2003 for the Company). The Company has not completed its analysis of the effects of FAS 144, but does not expect the impact of adoption to be significant to its financial position or results of operations.

10. LEGAL PROCEEDINGS

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

11. CUMULATIVE EFFECT OF ACCOUNTING CHANGE

During the fourth quarter of fiscal 2001, the Company adopted Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (SAB 101). Effective October 1, 2000, the Company recorded a cumulative effect charge of $1,901,853, net of an income tax benefit of $1,055,928, related to this accounting change. Upon adoption of SAB 101, the Company changed its revenue recognition policy with regard to certain product sales. The Company's previous policy stated that revenue is recognized upon shipment of products to customers. Essentially, the new policy recognizes that the risks and rewards of ownership in certain transactions did not substantively transfer to customers upon shipment of the products and therefore resulted in a deferral of revenue recognition until such products were received by the customers.

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

CONSOLIDATED RESULTS OF OPERATIONS

The following table sets forth selected information derived from the Company's interim condensed consolidated statements of operations expressed as percentages of sales:

	Three months ended March 31		% Increase (decrease)	Six months ended March 31		% Increase (decrease)
	2002	2001		2002	2001	
Net sales	100.0	100.0	(21.4)%	100.0	100.0	(24.9)%
Cost of sales	47.7	47.9	(21.8)	47.1	47.6	(25.6)
Gross margin	52.3	52.1	(21.1)	52.9	52.4	(24.2)
Operating expenses:						
Sales and marketing	31.0	24.9	(2.2)	28.8	22.8	(4.9)
Research and development	19.2	15.7	(4.4)	17.0	14.3	(11.0)
General and administrative	18.4	11.3	28.2	17.5	12.6	5.0
Acquired in-process research and development	12.3	—	100.0	6.2	—	100.0
Loss on sale of MiLAN assets	14.3	—	100.0	7.2	—	100.0
Restructuring	—	(0.1)	(100.0)	—	(0.3)	(100.0)
Total operating expenses	95.2	51.8	44.5	76.7	49.4	16.8
Operating (loss) income	(42.9)	0.3	(12,187.4)	(23.8)	3.1	(675.4)
Other income, net	0.4	1.5	(78.9)	0.9	2.2	(69.6)
(Loss) income before income taxes and cumulative effect of accounting change	(42.5)	1.8	(1,943.5)	(22.9)	5.3	(423.7)
Income tax (benefit) provision	(13.4)	0.8	(1,394.4)	(7.3)	2.6	(310.6)
(Loss) income before cumulative effect of accounting change	(29.1)	1.0	(2,391.3)	(15.6)	2.7	(533.0)
Cumulative effect of accounting change	—	—	—	—	(2.8)	100.0
Net (loss) income	(29.1)	1.0	(2,391.3)%	(15.6)	(0.1)	8,512.1%

NET SALES

Net sales in the three and six month periods ended March 31, 2002 were lower than net sales in the corresponding three and six month periods ended March 31, 2001, by $6.9 million or 21.4%, and $16.7 million or 24.9%, respectively. In addition to the factors discussed below, the Company's net sales in the first six months of fiscal 2002 were lower than net sales in the corresponding period of fiscal 2001, partially due to an industry-wide decline in demand associated with the economic downturn in the U.S.

Growth product sales, consisting of terminal servers, device servers, and USB, increased by $0.1 million and $0.6 million in the three and six month periods ended March 31, 2002 compared to the corresponding periods in fiscal 2001, primarily due to an increase in USB and device server product sales.

NET SALES (CONTINUED)

Total revenues for the three and six month periods ended March 31, 2002 were $25.2 million and $50.3 million as compared to sales of $32.1 million and $67.0 million for the three and six month periods ended March 31, 2001. This net decrease in sales resulted primarily from the following:

Mature product sales, consisting of asynchronous, synchronous, digital RAS, and ISDN products, decreased by $5.6 million and $14.1 million for the three and six month periods ended March 31, 2002 compared to the corresponding periods in fiscal 2001. The decrease in mature product sales is primarily a result of the Company's focus on expanding its market share in the growth product lines, as well as the discontinuation of the ISDN and digital RAS product lines.

Local area network (LAN) sales, which comprised the former MiLAN division, decreased by $4.7 million and $6.5 million in the three and six month periods ended March 31, 2002, compared to the corresponding periods in fiscal 2001. The decrease is primarily the result of the sale of the MiLAN Technology assets, which occurred on March 25, 2002.

Revenue generated by NetSilicon, which was acquired in February 2002, was $3.3 million in the three and six-month periods ended March 31, 2002.

The following table sets forth revenue by principal product group expressed as a percentage of net sales:

	Three months ended March 31		Six months ended March 31	
	2002	2001	2002	2001
Growth market products	35%	27%	35%	25%
Mature market products	46	54	47	57
MiLAN	6	19	11	18
Connectivity Solutions	87	100	93	100
Embedded Networking Solutions	13	—	7	—
Total	100%	100%	100%	100%

GROSS MARGIN

Gross margin for the three and six months ended March 31, 2002 was $13.2 million or 52.3% and $26.6 million or 52.9%, compared to $16.7 million or 52.1% and $35.1 million or 52.4% for the three and six months ended March 31, 2001. The increase in gross margin percentage was primarily the result of improved operating efficiencies in the Company's manufacturing operations and increased sales of higher margin products. NetSilicon added an incremental $1.6 million in gross margin for the second quarter of

GROSS MARGIN (CONTINUED)

fiscal 2002. Excluding a one time acquisition-related charge associated with inventory fair value adjustments of $0.3 million included in cost of sales, NetSilicon's gross margin would have been 56.9%.

As depicted in the revenue table, the Company's strategy is to improve market share in its growth product lines, which provide gross margins in a range of 50% to 60%. Although market share is eroding for the asynchronous legacy products, the Company is maintaining market share for these products, which have a comparable margin to the growth products, while converting customers who historically purchased legacy products to growth products.

OPERATING EXPENSES

The discussion of operating expenses which follows excludes a one-time charge of $3.1 million for acquired in-process research and development expenses associated with the acquisition of NetSilicon and a one-time charge of approximately $3.6 million associated with the sale of the assets of MiLAN (see Note 3 to the Company's consolidated financial statements.)

Operating expenses, excluding acquisition and asset sale related expenses and restructuring, for the three months ended March 31, 2002, increased $0.6 million, or 3.8%, as compared to operating expenses for the three months ended March 31, 2001. Operating expenses associated with NetSilicon and Decision Europe totaled $3.5 million. NetSilicon was acquired on February 13, 2002 and Decision Europe was acquired on June 8, 2001. Excluding the incremental expenses associated with NetSilicon and Decision Europe, operating expenses decreased by $2.9 million compared to the same quarter in the prior year. This decrease was due to workforce reductions, which took place throughout 2001, as well as continuing cost control measures.

Selling and marketing expenses decreased by $0.2 million from $8.0 million in the second quarter of fiscal 2001 to $7.8 million in the second quarter of fiscal 2002, or 2.2%. NetSilicon and Decision Europe incremental expenses for the second quarter of fiscal 2002 were $1.1 million. These incremental increases in selling and marketing expenses were offset primarily by the effect of workforce reductions made by the Company in September 2001, and by the reduction in commissions costs commensurate with the decrease in revenues.

Research and development expenses were $4.8 million, or 19.2% of sales, compared to $5.0 million, or 15.7% of net sales, for the three months ended March 31, 2002 and 2001, respectively. Research and development efforts have been focused on the device server, terminal server, USB, imaging, and intelligent device product lines. Increases in research and development expenses of approximately $1.7 million, resulting from research and development activities associated with the recently-acquired products of NetSilicon, Decision Europe and Inside Out networks, were offset by decreases in research and development expenditures primarily due to headcount reductions and other measures taken to decrease operating costs.

OPERATING EXPENSES (CONTINUED)

General and administrative expenses were $4.6 million, or 18.4% of net sales, compared to $3.6 million, or 11.3% of net sales, for the three months ended March 31, 2002 and 2001, respectively. NetSilicon and Decision Europe incremental general and administrative expenses account for the increase of $1.0 million in expenses, of which $0.5 million is incremental amortization expense. Other general and administrative expenses remained fairly stable in the current quarter as compared to the prior year comparable period.

Operating expenses, excluding acquisition and asset sale related charges and restructuring, for the six months ended March 31, 2002, were $31.9 million and decreased $1.4 million, or 4.2%, as compared to operating expenses of $33.3 million for the six months ended March 31, 2001. Operating expenses associated with NetSilicon and Decision Europe totaled $4.0 million. NetSilicon was acquired on February 13, 2002 and Decision Europe was acquired on June 8, 2001. Excluding the incremental expenses associated with NetSilicon and Decision Europe, operating expenses decreased by $5.4 million compared to the six month ended March 31, 2001. This decrease was due to workforce reductions, which took place throughout 2001, the closing of certain foreign sales offices, as well as continuing cost control measures.

Selling and marketing expenses, for the six months ending March 31, 2002, were $14.5 million, or 28.8% of net sales, compared to $15.3 million, or 22.8% of net sales for the six months ended March 31, 2001. Incremental sales and marketing expenses for Decision Europe and NetSilicon were $1.1 million. These incremental increases in selling and marketing expenses were offset primarily by the effect of workforce reductions made by the Company in September 2001, and by the reduction in commissions costs commensurate with the decrease in revenues.

Research and development expenses were $8.6 million, or 17.0% of sales, compared to $9.6 million, or 14.3% of sales, for the six months ending March 31, 2002 and March 31, 2001, respectively. Increases in research and development expenses of approximately $3.2 million, resulting from research and development activities associated with the recently-acquired products of NetSilicon, Decision Europe and Inside Out networks, were offset by decreases in research and development expenditures primarily due to headcount reductions and other measures taken to decrease operating costs.

General and administrative expenses were $8.8 million, or 17.5% of net sales, compared to $8.4 million, or 12.6% of net sales, for the six months ended March 31, 2002 and 2001, respectively. Incremental general and administrative expenses for NetSilicon and Decision Europe were $1.2 million, of which NetSilicon intangible asset amortization and amortization of Decision Europe goodwill represents $0.7 million. These incremental cost were partially offset primarily by reductions in costs resulting from the Company closing certain foreign sales offices during the second half of fiscal 2001, and cost reductions at some of the Company's foreign locations outside the U.S.

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT

On February 13, 2002, the Company acquired NetSilicon, Inc. (NetSilicon), a provider of Ethernet micro-processing solutions for intelligent, networked devices for a purchase price of $67,153,000. The transaction was accounted for using the purchase method of accounting. Accordingly, the purchase price

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

was allocated to the estimated fair value of assets acquired and liabilities assumed. Included in the purchase price allocation was a $3.1 million charge to acquired in-process research and development.

At the time of acquisition, NetSilicon had two development projects in process, the Net + 20 chip and the Net + OS v. 5.0. The Net + 20 project involved the creation of a chip that has strong functionality, but can be sold very inexpensively. The Net + OS v. 5.0 relates to the creation of an operating system that has increased functionality, especially in the areas of security and management. The new technology being utilized to develop a lower priced chip and the new technology to create an operating system with increased functionality differed significantly from previous projects due to the challenges of building a chip in the lower price range and differences in technology in the predecessor operating system that is currently being sold. According, the Company was uncertain whether the technology being developed could become commercially viable. 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 $3.1 million of the purchase price represents the fair value of purchased in-process research and development related to the Net + 20 chip and the Net + OS v. 5.0 operating system referred to above, that had not yet reached technological feasibility and had no alternative future uses. This amount was expensed as a non-recurring, non-tax-deductible charge upon consummation of the acquisition.

The Company utilized the 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 NetSilicon's estimate of top-line revenue growth over the next four fiscal years, primarily from the revenue growth of the Net + 50 and the Net + 20 chips.

- The estimated gross margin is based upon historical gross margin for NetSilicon's products, which include chips, boards, and development kits. Average gross margin is approximately 57.5%.

- The estimated selling, general and administrative expenses for NetSilicon are projected to decrease as a percent of sales.

- The discount rate used 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 discount rate used in the alternative valuation approach was 18.0%. Premiums were added to the WACC to account for the inherent risks in the development of the products, the risks of the products being completed on schedule, and the risk of the eventual sales of the product meeting the expectations of the Company. The following rates of return were used for the in-process research and development products:

Net	+ 20	35%
Net	+ OS v. 5.0	30%

ACQUIRED IN-PROCESS RESEARCH AND DEVELOPMENT (CONTINUED)

Management estimates that the projects will be complete within the next year. Management has also estimated that the remaining completion costs (primarily research and development expenses) is approximately $1,023,000. 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.

LOSS ON SALE OF MiLAN ASSETS

On March 25, 2002, the Company sold substantially all of the assets of Digi's former MiLAN Technology division, to Communications Systems, Inc for $8.1 million, resulting in a pre tax loss of $3.6 million ($3.1 million net of taxes). Included in the net loss on this transaction is $0.9 million of severance costs related to certain former employees of MiLAN.

OTHER INCOME (EXPENSE)

Other income for the three months ended March 31, 2002 decreased $0.4 million versus the comparable quarter a year ago. Investment income decreased by $0.5 million, primarily due to the decline in interest rates during the first three months of fiscal 2002 compared to the first three months of fiscal 2001. Interest expense decreased $0.1 million during the first three months of fiscal 2002 versus the comparable period a year ago, primarily due to the decrease in the debt balance.

Other income for the six months ended March 31, 2002 decreased by $1.0 million versus the six-month period a year ago. Investment income decreased by $0.8 million, reflecting the decrease in interest rates during the calendar year 2001 and continuing into the beginning of calendar 2002. Interest expense decreased by $0.2 million in the first six months of fiscal 2002 compared to the first six months of fiscal 2001 due primarily to the decrease in the debt balance.

INCOME TAXES

Income taxes have been provided for at estimated annual effective rate of 32.0% for the six month period ended March 31, 2002, versus 35.7% for the fiscal year ended September 30, 2001. The decrease in the effective income tax rates resulted primarily from non-deductible goodwill associated with the loss on sale of MiLAN assets and non-deductible acquired in-process research and development associated with the acquisition of NetSilicon, partially offset by the increase in the mix of foreign source income taxed at a lower rate.

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

FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2002, the company had cash, cash equivalents and marketable securities of $52.8 million compared to $56.2 million at September 30, 2001. The Company has financed its operations principally with funds generated from operations. The Company's working capital decreased from $74.2 million at September 30, 2001, to $63.0 million at March 31, 2002.

Net cash provided by operating activities for the six months ended March 31, 2002, was $2.5 million, compared to net cash provided by operating activities of $3.5 million for the six months ended March 31, 2001. Changes in operating assets and liabilities resulted in the use of $1.9 million and $1.6 million of cash during the six months ended March 31, 2002 and 2001, respectively. A decrease in accounts payable and accrued liabilities resulted in the use of $4.0 million of cash during the six months ended March 31, 2002, compared to an increase of $0.8 million during the same period one year ago. These changes in accounts payable and accrued expenses related primarily to the timing of vendor payments, $5.0 million of which were assumed as a result of the NetSilicon acquisition. Collections on accounts receivable balances provided $3.0 million during the six months ended March 31, 2002 compared to an increase in accounts receivable that used $3.0 million during the same period one year ago. These increases and decreases in accounts receivable relate primarily to the timing of sales in these respective quarters.

Net cash provided by investing activities for the six months ended March 31, 2002 was $6.1 million compared to $21.8 million used during the same period one year ago. Net sales of marketable securities were $10.8 million during the six months ended March 31, 2002, compared to net purchases of $14.0 million during same period one year ago. Proceeds from the sale of all assets of MiLAN provided $8.1 million in March 2002. In February 2002, the Company used $10.4 million ($16.3 million net of cash acquired of $5.9 million) as a result of the acquisition of NetSilicon. In October 2000, the Company acquired Inside Out Networks, resulting in a net cash outflow of approximately $7.2 million. In November 2001 the Company paid an additional $1.4 million relating to the Inside Out Networks acquisition based upon the achievement of specific revenue and operating income targets specified in the purchase agreement. In March 2002, the Company paid $600,000 relating to the INXTECH acquisition upon Decision Europe achieving certain product development milestones. Purchases of equipment and capital improvements were $0.3 million and $0.6 million for the six months ended March 31, 2002 and 2001, respectively.

Financing activities during the six month period ended March 31, 2002, used $1.3 million, compared to $0.3 million during the six month period ended March 31, 2001. Principal payments on line of credit and long-term debt obligations were $1.7 million during the six months ended March 31, 2002 compared to payments of $0.9 million during the same period one year ago. Cash received from the exercise of employee stock options and employee stock purchase plan transactions was $0.4 million and $0.5 million for the six months ended March 31, 2002 and 2001, respectively.

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

FINANCIAL CONDITION (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

The following summarizes the Company's contractual obligations at March 31, 2002, and the effect such obligations are expected to have on liquidity and cash flow in future periods. However, this table excludes up to $7.1 million and $1.9 million of additional purchase consideration that may be payable to the former shareholders of Inside Out Networks and Decision Europe in the event that, in the future, these operations achieve certain development and operating milestones.

Contractual Obligations

	Payments due by period						
(in thousands)	**2002**	**2003**	**2004**	**2005**	**2006**	**Thereafter**	**Total**
Long-term debt	$ 318	$ 833	$365	$364	$364	$3,148	$5,392
Operating leases	728	921	466	295	49	81	2,540
Total contractual cash obligations	$1,046	$1,754	$831	$659	$413	$3,229	$7,932

The Company maintains a line of credit with Deutsche Bank that provides for borrowings of up to $5.0 million depending upon levels of eligible accounts receivable and inventories. As of March 31, 2002, the Company had borrowed $0.5 million under this credit line. The Company is required to maintain a $2.0 million deposit in a financial institution as collateral for the European credit line. This collateral is included in marketable securities at March 31, 2002.

Long-term debt consists of fixed rate, collateralized and uncollateralized notes bearing interest at rates ranging from 5.0% to 6.25%. The notes are collateralized by land, buildings and equipment with a carrying value of $4.6 million at March 31, 2002.

All of the long-term debt was incurred in connection with the construction of the Dortmund, Germany facility, which the Company is attempting to sell. The Company intends to prepay all long-term debt if the Dortmund facility is sold.

The Company has entered into various operating lease agreements for office space and equipment.

FOREIGN CURRENCY

Effective January 1, 1999, eleven countries of the European Union converted to a common currency called the "Euro." All invoicing activity within the European Union is required to be transacted in Euros, effective January 1, 2002. This action will cause some of the Company's European transactions to be negotiated, invoiced, and paid in Euros. Additional currency risk may exist when sales from the United States into the European Union are transacted in Euros rather than US dollars.

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

FINANCIAL CONDITION (CONTINUED)

FOREIGN CURRENCY (CONTINUED)

For the three and six month periods ended March 31, 2002, the Company had approximately $7.3 million and $15.4 million of net sales related to foreign customers, respectively. For the three months ended March 31, 2002, $4.3 million was denominated in U.S. dollars and $3.0 million was denominated in Euros. For the six months ended March 31, 2002, $9.6 million was denominated in U.S. dollars, $2.9 million was denominated in Deutschemarks, and $3.0 million was denominated in Euros. Effective January 1, 2002, unpaid invoices of $1.4 million relating to sales denominated in Deutschemarks were converted to Euros. The accounts receivable balance relating to the Company’s European operations, included $1.6 million Euros at March 31, 2002.

The Company continues to hold long-term debt in Dortmund, Germany (ITK), related to the facility in Dortmund. This debt had been denominated in Deutschemarks. Effective January 1, 2002 this debt balance was converted to debt denominated in Euros. The debt balance of 6.2 million Euros at March 31, 2002, is subject to fluctuations as a result of Euro exchange rate changes.

In future periods, a significant portion of sales will be made in Euros. The Company has not implemented a hedging strategy to reduce the risk of foreign currency translation exposures as management does not believe those risks are significant at this time.

INFLATION

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

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

This Form 10-Q contains statements that constitute “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, which generally can be identified by the use of forward-looking terminology such as “anticipate,” “believe,” “target,” “estimate,” “may,” “will,” “expect,” “plan,” “project,” “should,” or “continue” or the negative thereof or other variations thereon or similar terminology. Such statements are based on information available to management as of the time of such statements and relate to, among other things, the anticipated benefits of the NetSilicon acquisition**,** 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. Such statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, including the possibility that the NetSilicon acquisition will not be consummated**,** risks related to the highly competitive market in which the Company operates, rapid changes in technologies that may displace products sold by the Company, declining prices of networking products, the Company’s reliance on distributors, delays in the Company’s product development efforts, uncertainty in consumer acceptance of the Company’s

FINANCIAL CONDITION (CONTINUED)

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

products, and 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 and Exchange Commission, including without limitation, its annual reports on Form 10-K and its quarterly reports on Form 10-Q and the Company's definitive proxy statement dated January 9, 2002 with respect to the NetSilicon merger, could cause the Company's future results to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company. Many of such factors are beyond the Company's ability to control to predict. These forward-looking statements speak only as of the date for which they are made. The Company disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

RECENT ACCOUNTING DEVELOPMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), and No. 142, "Goodwill and Other Intangible Assets" (FAS 142). The most significant changes made by FAS No. 141 are: 1) requiring that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and 2) establishing specific criteria for the recognition of intangible assets separately from goodwill. FAS No. 142 primarily addresses the accounting for acquired goodwill and intangible assets (i.e., the post-acquisition accounting). The Company will adopt the provisions of FAS No. 142 at the beginning of fiscal year 2003. However, the transition provisions of FAS No.142 do apply to the Company's accounting for the NetSilicon acquisition as this acquisition occurred after June 30, 2001. The most significant changes made by FAS No. 142 are: 1) goodwill and indefinite-lived intangible assets will no longer be amortized, and 2) goodwill and indefinite-lived intangible assets will be tested for impairment at least annually. Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the non-amortization and amortization provisions of this statement. These standards only permit prospective application of the new accounting; accordingly, adoption of these standards will not affect previously reported financial information of the Company. Although the Company has not completed its assessment of the impact of the adoption of FAS 142, management believes that the principal effect will be the Company ceasing the amortization of goodwill and assembled workforce. Goodwill and assembled workforce amortization was approximately $1,300,000 and $1,191,000 for the six months ended March 31, 2002 and 2001, respectively. Goodwill and assembled workforce amortization was approximately $2,427,000 for the year ended September 30, 2001.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (FAS 143), which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. FAS 143 requires an entity to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred. Upon initial recognition of a liability for an asset retirement obligation, an entity shall capitalize an asset retirement cost by increasing the carrying amount of the

related long-lived asset by the same amount as the liability. FAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company has not completed its assessment of the impact of adoption of FAS 143.

In August 2001, the FASB issued FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (FAS 144). This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets, except for goodwill and indefinite-lived intangible assets, which is addressed by FAS 142. FAS 144 retains and expands upon the fundamental provisions of existing guidance related to the recognition and measurement of the impairment of long-lived assets to be held and used and the measurement of long-lived assets to be disposed of by sale. Generally, the provisions of FAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001 (fiscal 2003 for the Company). The Company has not completed its analysis of the effects of FAS 144 but does not expect the impact of adoption to be significant to its financial position or results of operations.

CRITICAL ACCOUNTING POLICIES

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

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

REVENUE RECOGNITION

The Company's revenues are derived primarily from the sale of products to its distributor and original equipment manufacturer (OEM) customers, and to a lesser extent from the sale of software licenses, fees associated with technical support, training and engineering services and royalties. Generally revenue from product sales is recognized at the date that products are shipped to distributors or OEM customers. Sales to authorized domestic distributors and original equipment manufacturers are made with certain rights of return and price protection provisions. Estimated reserves for future returns and pricing adjustments are established by the Company based on analysis of historical patterns of returns and price protection claims as well as an analysis of authorized returns compared to received returns, current on-hand inventory at

REVENUE RECOGNITION (CONTINUED)

distributors, and distribution sales for the current period . Estimated reserves for future returns and price protection are charged against revenues in the same period as the corresponding sales are recorded. Estimated warranty costs are accrued based on historical experience and current business factors, and are recorded in the same period as the corresponding sales.

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 as a reduction in revenue in the same period as the corresponding sales.

The Company recognizes license revenue upon meeting each of the following criteria: execution of a license agreement or contract; delivery of software; the license fee is fixed or determinable; collectibility of the proceeds is assessed as being probable; and vendor specific objective evidence exists to allocate the total fee to undelivered elements of the arrangement. Vendor-specific objective evidence is based on the price charged when an element is sold separately. The Company's software development tools and development boards often include multiple elements, including hardware, software, post contract customer support ("PCS"), limited training and a basic hardware design review. Customers purchase these products and services during their product development process in which they use the tools to build network connectivity into the devices they are manufacturing. The Company recognizes revenue related to these multiple element arrangements in accordance with Statement of Position ("SOP") No. 97-2 "Software Revenue Recognition," as amended by SOP 98-4, "Deferral of the Effective Date of Certain Provisions of SOP 97-2." The portion of revenue allocated to hardware and software licenses is recognized upon shipment, while the portion of the revenue allocated to PCS is recognized ratably over the term of the PCS arrangement and the portion of revenue allocated to training and the hardware design review is recognized when the service is performed.

INVENTORY

The Company establishes valuation reserves on its inventories for estimated excess and obsolete inventory equal to the difference between the cost of inventory and its estimated market value based upon assumptions about future product demand and market conditions. If actual product demand or market conditions are less favorable than those projected by management, additional inventory reserves may be required.

INTANGIBLE ASSETS

Purchased proven technology, license agreements, covenants not to compete and other intangible assets are recorded at fair value when acquired in a business acquisition, or at cost when purchased directly. Goodwill represents the excess of cost over the fair value of identifiable assets acquired and, for acquisitions prior to June 30, 2001 is being amortized on a straight-line basis over estimated useful life periods ranging from five to fifteen years. Fort goodwill resulting from the NetSilicon acquisition, which

occurred after June 30, 2001, goodwill is not amortized but will be subject to an impairment assessment at least annually. 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 four to ten years. Useful lives for intangible assets are estimated at the time of acquisition based on the periods of time from which the Company expects to derive benefits from the intangible assets.

Intangible assets are reviewed quarterly for impairment, or whenever events or circumstances indicate that the asset's undiscounted expected future cash flows are not sufficient to recover the carrying amount. The Company measures impairment loss by comparing the fair market value, calculated as the present value of expected future cash flows, to its net book value or carrying amount. Impairment losses, if any, are recorded currently.

SOFTWARE DEVELOPMENT

Research and development costs are expenses when incurred. Software development costs where technological feasibility has not been established are expensed in the period in which they occurred; otherwise, development costs that will become an integral part of the Company's products are deferred in accordance with Statement of Financial Accounting Standards ("SFAS") No 86. The deferred costs are amortized to cost of sales using the straight-line method over the remaining two to three year economic life of the product or the ratio that current revenues for the product bear to the total of current and anticipated future revenues for that product.

The recoverability of capitalized software costs are reviewed on an ongoing basis primarily based upon projections of undiscounted future operating cash flows from each software product line. The excess amount, if any, of the remaining net book value over the calculated amount is fully reserved.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not have material exposure to market risk from market risk sensitive financial instruments other than the currency risk associated with certain transactions being denominated in Euros.

The Company has some exposure to credit risk related to its accounts receivable portfolio. Exposure to credit risk is controlled through continuous monitoring procedures, credit limits and collaboration with sales management on customer contracts to facilitate payment.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

At the Annual Meeting of Stockholders held on January 23, 2002, the stockholders voted on the following:

(a) Proposal to elect one director, Mykola Moroz, for a two-year term and two directors, Joseph T. Dunsmore and Bradley J. Williams, for a three year term. Mr. Moroz was elected on a vote of 14,009,527 in favor, with 80,298 shares withholding authority to vote. Mr. Dunsmore was elected on a vote of 12,596,194 in favor, with 1,493,631 shares withholding authority to vote. Mr. Williams was elected on a vote of 12,596,494 in favor, with 1,493,631 shares withholding authority to vote. There were no broker non-votes.

(b) Proposal to approve the amendment of the Digi International Inc. Employee Stock Purchase Plan (the Plan) to reserve 750,000 additional shares of Common Stock for future purchases under the Plan. This proposal passed on a vote of 11,484,104 in favor, 2,114,511 against and 491,210 abstentions and no broker non-votes.

(c) Proposal to ratify the appointment of PricewaterhouseCoopers LLP as independent public accountants of the Company for fiscal year 2002. The proposal passed on a vote of 12,606,186 in favor, 1,474,184 against and 9,455 abstentions and no broker non-votes.

At the Special Meeting of Stockholders held on February 13, 2002, the stockholders voted on the following:

(a) Proposal to approve the issuance of shares of Digi Common Stock in the merger of NetSilicon, Inc. into Dove Sub Inc., a wholly owned subsidiary of Digi, under the Agreement and Plan of Merger, dated as of October 30, 2001, among Digi, Dove Sub and NetSilicon. The proposal passed on a vote of 9,158,887 in favor, 1,751,362 against and 63,983 abstentions and no broker non-votes.

PART II. OTHER INFORMATION (CONTINUED)

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit No.	Description
3(a)	Restated Certificate of Incorporation of the Registrant, as Amended (1)
3(b)	Amended and Restated By-Laws of the Registrant (2)
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (3)
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent(4)
10(c)(ii)	Management Agreement between the Company and Douglas Glader dated as of March 25, 2002
10(g)	Employee Stock Purchase Plan, as amended, of the Company (5)
10(j)	Second Amended and Restated Employment Agreement dated as of October 30, 2001 between NetSilicon, Inc. and Cornelius Peterson, VIII
10(k)	Digi International Inc. Non-Officer Stock Option Plan, as amended (6)
10(l)	NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan (7)
10(m)	NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (8)
10(n)	NetSilicon, Inc. 2001 Stock Option and Incentive Plan (9)
10(o)	Asset Purchase Agreement, dated as of March 21, 2002, by and between the Company and Communications Systems, Inc. (10)

PART II. OTHER INFORMATION (CONTINUED)

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K (CONTINUED)

10(o)(ii) Amendment No. 1 to Asset Purchase Agreement, dated as of March 25, 2002, by and between the Company and Communications Systems, Inc. (11)

(b) Reports on Form 8-K:

The following reports on Form 8-K were filed during the quarter ended March 31, 2002:

Form 8-K, dated January 16, 2002, announcing the Company's first fiscal quarter 2002 financial results.

Form 8-K, dated February 22, 2002, announcing the Company's merger with NetSilicon, Inc.

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

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

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

(5) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82674)

(6) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82674)

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

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

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

(10) Incorporated by reference to Exhibit 2.1 to the Company's Form 8-K dated April 5, 2002 (File No. 0-17972)

(11) Incorporated by reference to Exhibit 2.2 to the Company's Form 8-K dated April 5, 2002 (File No. 0-17972)

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

DIGI INTERNATIONAL INC.

Date: May 15, 2002

By: /s/ S. Krishnan

S. Krishnan
Chief Financial Officer
(duly authorized officer and
Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	Document Description	Form of Filing
3(a)	Restated Certificate of Incorporation of the Registrant, as Amended (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1993 (File No. 0-17972))	Incorporated by Reference
3(b)	Amended and Restated By-Laws of the Registrant (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 2001 (File No. 0-17972))	Incorporated by Reference
4(a)	Form of Rights Agreement, dated as of June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A dated June 24, 1998 (File No. 0-17972))	Incorporated by Reference
4(b)	Amendment dated January 26, 1999, to Share Rights Agreement, dated June 10, 1998 between Digi International Inc. and Wells Fargo Bank Minnesota, National Association (formerly known as Norwest Bank Minnesota, National Association), as Rights Agent (incorporated by reference to Exhibit 1 to Amendment No. 1 to the Company's Registration Statement on Form 8-A dated February 5, 1999 (File No. 0-17972))	Incorporated by Reference
10(c)(ii)	Management Agreement between the Company and Douglas Glader dated as of March 25, 2002	Filed Electronically
10(g)	Employee Stock Purchase Plan, as amended, of the Company (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82674))	Incorporated by Reference

Exhibit Number	Document Description	Form of Filing
10(j)	Second Amended and Restated Employment Agreement dated as of October 30, 2001 between NetSilicon, Inc. and Cornelius Peterson, VIII	Filed Electronically
10(k)	Digi International Inc. Non-Officer Stock Option Plan, as amended (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82674))	Incorporated by Reference
10(l)	NetSilicon, Inc. Amended and Restated 1998 Director Stock Option Plan (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82672))	Incorporated by Reference
10(m)	NetSilicon, Inc. Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82670))	Incorporated by Reference
10(n)	NetSilicon, Inc. 2001 Stock Option and Incentive Plan (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 dated February 13, 2002 (File No. 333-82668))	Incorporated by Reference
10(o)	Asset Purchase Agreement, dated as of March 21, 2002, by and between the Company and Communications Systems, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K dated April 5, 2002 (File No. 0-17972)	Incorporated by Reference
10(o)(ii)	Amendment No. 1 to Asset Purchase Agreement, dated as of March 25, 2002, by and between the Company and Communications Systems, Inc. (incorporated by reference to Exhibit 2.2 to the Company's Form 8-K dated April 5, 2002 (File No. 0-17972)	Incorporated by Reference

EXHIBIT 10(c)(ii)

MANAGEMENT AGREEMENT

THIS AGREEMENT is made as of the 25th day of March, 2002 by and between Digi International Inc., a Delaware corporation, with its principal executive office in Minnetonka, Minnesota ("Company") and Douglas J. Glader, a resident of California (the "Executive").

WHEREAS, the Executive is employed as Executive Vice President of the Company and General Manager of MiLAN Technology, a division of the Company ("MiLAN"); and

WHEREAS, the Executive and the Company are parties to an Employment Agreement dated February 6, 1995, as amended (the "Employment Agreement"); and

WHEREAS, the Company recognizes that the possibility of a Sale of Business of MiLAN may occur and that such possibility, and the uncertainty and questions which it may raise among management, may result in the departure or distraction of the Executive in the performance of the Executive's duties to the detriment of the Company and its shareholders; and

WHEREAS, it is desirable and in the best interests of the Company and its shareholders to provide inducement to Executive to remain in the service of the Company in the event of a Sale of Business of MiLAN without regard to the possibility that Executive's employment may be terminated in connection with such Sale of Business; and

WHEREAS, the Executive and the Company have agreed to compensation for Executive in the event of a Sale of Business of MiLAN, in accordance with the terms and conditions of this Agreement;

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

1. Term of Agreement. This Agreement shall commence on the date hereof and shall continue in effect until a "Sale of Business" (as hereinafter defined) of MiLAN; provided, however, that if a Sale of Business occurs as the result of a sale of substantially all, but not all, the assets of MiLAN, then this Agreement shall continue in effect with respect to any subsequent sale during Executive's active employment with the Company of the remaining portion of MiLAN as a going concern (the "Term"), and such subsequent sale shall be considered part of the same Sale of Business. Except as set forth in Section 2(b) of this Agreement, nothing stated herein shall limit the right of the Executive or the Company to terminate the employment of the Executive with the Company at any time prior to, at, or after the expiration of the Term of this Agreement, with or without cause and for any reason whatsoever, subject to the right of the Executive to receive any payment and

other benefits that may be due pursuant to the terms and conditions of Section 4 of this Agreement or of the Employment Agreement, as applicable.

2. Sale of Business. No amounts shall be payable hereunder unless a Sale of Business of MiLAN, as set forth below, shall occur.

(a) For purposes of this Agreement, a "Sale of Business" of MiLAN shall be deemed to occur upon the sale or other disposition of all or substantially all of the assets of MiLAN (in one transaction or a series of transactions). Notwithstanding the foregoing, no Sale of Business shall be deemed to have occurred (i) if a majority of the voting stock (or the voting equity interest) of any corporation (or other entity) acquiring all or substantially all of the assets of MiLAN is, immediately following the disposition of assets, beneficially owned by the Executive or a group of persons, including the Executive, acting in concert, or (ii) as a result of a reorganization in which all or substantially all of the assets of MiLAN are owned by an entity that is wholly owned or majority owned, directly or indirectly, by the Company.

(b) The Executive agrees that in the event of a Sale of Business of MiLAN during the Term, the Executive, if employed by the Company immediately prior to such a Sale of Business, will remain as an employee of the Company and will make himself available to provide services to any buyer of the assets of MiLAN for a period of time, if any, agreed upon by the Company and such buyer, not to exceed 60 days after the occurrence of such a Sale of Business of MiLAN (such period referred to as the "Transition Period").

(c) If Executive and the Company are unable to reach agreement on the terms and conditions of continued employment of Executive with the Company, then the Company will terminate Executive's active employment upon completion of any Transition Period, subject to any right of continued employment during a Severance Period pursuant to Section 4 hereof.

3. Incentive Compensation for Sale of Business. If a Sale of Business of MiLAN occurs and (i) Executive is employed by the Company immediately prior to such Sale of Business or (ii) Executive's employment was terminated by the Company without "cause" (as defined in the Employment Agreement) within one (1) year prior to such Sale of Business, the Company will pay Executive incentive compensation calculated as a percentage of the purchase price received by the Company as a result of such Sale of Business, in accordance with the attached Exhibit A. Any incentive compensation payable to Executive under this Section 3 shall be due and payable to Executive only when, as and if the Company receives the purchase payment (or payments) for such Sale of Business. The Company and Executive agree that the Housing Normalization Payments (as defined and provided in the

Employment Agreement) shall continue to be paid by the Company during Executive's employment until May 31, 2002, after which time the Company's obligation to make such Housing Normalization Payments shall cease.

4. Termination Following Sale of Business.

(a) If a Sale of Business of MiLAN occurs and (i) Executive is employed by the Company immediately prior to such Sale of Business and for the duration of any Transition Period, (ii) the Company terminates Executive's active employment at or after completion of any Transition Period for reasons other than for "cause" (as defined in the Employment Agreement), and (iii) Executive does not accept in his sole discretion employment after the Transition Period with any buyer of the assets of MiLAN, then Executive shall be entitled to the following payments and other benefits:

(i) the Company shall continue to employ Executive and to pay to the Executive an amount equal to Executive's base salary, which shall not be less than Executive's base salary on the date hereof, for a period of one year after any Transition Period, in accordance with the Company's normal payroll practices (the "Severance Period");

(ii) the Company shall pay the Executive an amount equal to the annual cash bonus award Executive would have earned for the fiscal year in which the Sale of Business occurs, based on the average percentage achievement levels of other senior managers of the Company, such payment to be made in the same manner and at the same time as other senior managers of the Company receive their annual cash bonus awards; provided, however, that the cash bonus award payable to Executive under this subsection shall be prorated based on the number of calendar days that Executive was actively employed by the Company during the fiscal year in which the Sale of Business occurs (not including as active employment any days that Executive is employed by the Company during the Severance Period); and

(iii) the Company shall continue to allow Executive to participate in the Company's group insurance and retirement benefit plans during the Severance Period, in accordance with the terms and conditions of such plans as then in effect.

(b) During the Severance Period, Executive will continue to be an employee of the Company (including without limitation for purposes of the Company's stock option plan) and shall assist the Company with transition matters as reasonably requested. The salary continuation and other benefits

payable during the Severance Period pursuant to Section 4(a) shall be in lieu of, and not in addition to, any severance pay or benefits that the Executive may be entitled to receive from the Company under the Employment Agreement or any other policy or agreement of the Company. Executive shall not be entitled to receive bonus, Housing Normalization Payments, or any other compensation or benefits from the Company during the Severance Period except as expressly provided in Section 3 or Section 4(a).

(c) If Executive's employment has not been earlier terminated by the Company for "cause" (as defined in the Employment Agreement), upon completion of the Severance Period the Company will terminate Executive's employment with the Company without cause and without additional obligation to Executive for severance pay or other compensation (other than any acceleration of vesting of stock options of the Executive to which Executive is entitled pursuant to the terms of any written stock option agreement between Executive and the Company).

(d) If Executive in his sole discretion accepts employment with any buyer of the assets of MiLAN after the Transition Period, then Executive's employment with the Company shall end effective the last day of the Transition Period. Thereafter and for a period of six (6) months after the Transition Period (the "Consulting Period"), Executive will become a consultant to the Company and will make himself available to provide consulting services to the Company up to a maximum of two (2) hours in any calendar month. The Company will compensate Executive during the Consulting Period at the rate of $200 per month. During the Consulting Period, Executive shall be an independent contractor of the Company and shall not be eligible for any employee benefits or programs of the Company, except for his continued participation in the Digi International Inc. Stock Option Plan and Digi International Inc. 2000 Omnibus Stock Plan in accordance with the terms of those plans and as set forth in Section 6 of this Agreement.

5. Repayment of Loan and Right of Offset. In the event that the full amount of any loans from the Company to Executive has not been repaid by Executive as of the Sale of Business of MiLAN, then the Company may offset the loan balance from any amounts payable to Executive under Section 3 or Section 4(a).

6. Stock Options. The Company agrees with Executive (i) that Executive will continue to be an eligible participant in the Digi International Inc. Stock Option Plan and Digi International Inc. 2000 Omnibus Stock Plan, during any Transition Period, Severance Period and/or Consulting Period, and that his unvested options will continue to vest during any Transition Period, Severance Period and/or Consulting Period, and (ii) that any options that are vested as of the end of the Severance Period or Consulting Period, as applicable, would continue to be exercisable for a three (3) month period thereafter, provided that in no

event shall any option be exercisable more than ten (10) years from its date of grant. The Company agrees with Executive that any unvested stock options issued to Executive that vest by their terms upon a Sale of Business would so vest.

7. Notice. For the purpose of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by United States registered or certified mail, return receipt requested, postage pre-paid, addressed to the last known residence address of the Executive or in the case of the Company, to its principal executive office to the attention of the Chief Executive Officer, with a copy to the Chief Financial Officer, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

8. Successors and Assigns. This Agreement is binding on and inures to the benefit of the Executive and Executive's heirs and legal representatives, and on the Company and its successors and assigns. No rights or obligations of the Executive or the Company hereunder may be assigned, pledged, disposed of or transferred by such party to any other person or entity without the prior written consent of the other party.

9. Governing Law. This Agreement shall be construed under and governed by the laws of the State of Minnesota.

10. Entire Agreement. This Agreement constitutes the entire agreement between Executive and the Company regarding the subject matters contained herein and supersedes all prior agreements relating to such subject matters.

11. Amendments and Waivers. No provision hereof may be altered, amended, modified, waived or discharged in any way whatsoever except by written agreement executed by both parties. No delay or failure of either party to insist, in any one or more instances, upon performance of any of the terms and conditions of this Agreement or to exercise any rights or remedies hereunder shall constitute a waiver or a relinquishment of such rights or remedies or any other rights or remedies hereunder.

12. Counterparts. This Agreement may be executed in counterparts, each of which when so executed shall be deemed to be an original, and such counterparts shall together constitute one and the same instrument.

DIGI INTERNATIONAL INC.	EXECUTIVE
By /s/ Subramanian Krishnan	/s/ Douglas J. Glader
Its Senior Vice President and CFO	DOUGLAS J. GLADER

EXHIBIT A
TO MANAGEMENT AGREEMENT

INCENTIVE COMPENSATION

Incentive compensation pursuant to Section 3 of the Agreement shall be determined by the following matrix:

INCENTIVE COMPENSATION AS PERCENTAGE OF SALE OF BUSINESS VALUE	SALE OF BUSINESS VALUE
2%	$5,000,000 or less
$100,000 plus 5% of the Value between $5,000,000 and $7,500,000	$5,000,000 to $7,499,999
3%	$7,500,000
$225,000 plus 7% of the Value between $7,500,000 and $10,000,000	$7,500,000 to $9,999,999
4.5%	$10,000,000 or more

"Sale of Business Value" shall mean the total fair market value of all cash, equity securities, property, debt or other obligations and any other form of consideration paid directly or indirectly (including, in the case of an acquisition of assets, the current value of any long-term liabilities assumed, directly or indirectly, by any acquiring party in connection with the Sale of Business) by any acquiring party to the Company in connection with the Sale of Business of MiLAN. If such Sale of Business occurs in a series of transactions, the Sale of Business Value shall be the aggregate fair market value of the consideration for each transaction, and the incentive compensation payable on later transactions comprising the Sale of Business shall be incremental based on the Sale of Business Value.

The fair market value, in the case of publicly traded equity securities, shall be based on the last closing sale price in the primary public market for such securities on the last trading day prior to the date the acquisition is first publicly announced. The Sale of Business Value shall be calculated without deducting any of the Company's transaction expenses, including without limitation, any brokerage fees, any fees and expenses of attorneys, accountants or other advisors.

EXHIBIT 10(j)

SECOND AMENDED AND RESTATED EMPLOYMENT AGREEMENT (the "Agreement") made as of October 30, 2001, by and between NetSilicon, Inc., a Massachusetts corporation (the "Company"), and Cornelius Peterson, VIII (the "Executive").

WHEREAS, the Company has entered into an Agreement and Plan of Merger by and among the Company, Digi International Inc., a Delaware corporation ("Digi"), and Dove Sub Inc., a wholly owned subsidiary of Digi ("Dove Sub"), dated as of October 30, 2001 (the "Merger Agreement"), pursuant to which the Company shall be merged with and into Dove Sub (the "Merger"); and

WHEREAS, the Executive has been providing services to the Company pursuant to an Employment Agreement dated as of August 9, 2001, as amended by the First Amended and Restated Employment Agreement dated as of October 30, 2001;

WHEREAS, it is a condition to Digi's and the Company's executing the Merger Agreement that the Executive enter into this Agreement;

WHEREAS, the parties hereto desire to amend and restate the First Amended and Restated Employment Agreement in its entirety as set forth herein, subject to consummation of the Merger and effective upon the Effective Time (as defined in the Merger Agreement); and

WHEREAS, if the Merger is not consummated, this Agreement shall be null and void.

NOW, THEREFORE, in consideration of the foregoing premises and the respective agreements of the Company and Executive set forth below, the Company and Executive, intending to be legally bound, agree as follows:

1) Term.

(a) The Company hereby agrees to continue to employ the Executive and the Executive hereby agrees to continue employment with the Company, in the positions set forth in Section 2 below, for the Term (as defined below), subject to the terms and conditions of this Agreement.

(b) The term (the "Term") of this Agreement shall commence as of the Effective Time (as defined in the Merger Agreement) and shall continue until the date 18 months following the Effective Time unless terminated earlier in accordance with Section 4.

2) Position, Duties and Responsibilities.

(a) During the Term, the Executive shall be employed by the Company and shall serve the Company as Senior Vice President of Business Development. The Executive shall have such duties and responsibilities as are incident to, or reasonably requested in connection with, such positions, as well as such other comparable duties and responsibilities as may be agreed upon by him and the Chief Executive Officer of Digi

and/or Digi's Board of Directors ("Digi's BOD"). The Executive shall report to the Chief Executive Officer of Digi.

(b) During the Term, the Executive shall serve the Company faithfully, diligently and to the best of the Executive's ability, and shall devote substantially all of his business time and efforts to such service. The Executive also shall not engage in any other business activity without the written consent of the Chief Executive Officer of Digi, except that the Executive may (i) carry on charitable, civic, or other not-for-profit activities or (ii) manage his personal investments, provided that none such activities conflict with the Executive's duties under this Agreement and the Non-Disclosure, Proprietary Rights and Non-Solicitation Agreement entered into between the Executive and the Company dated May 2, 2000 (the "Nondisclosure Agreement"). If the Executive shall be elected to other offices of the Company, Digi or any of their affiliates, and if the Executive shall in his sole discretion accept in writing the election to such offices, he shall serve in such positions without further compensation than provided for in this Agreement. Notwithstanding the foregoing, the Executive agrees to serve as a director of Digi without compensation (other than reimbursement for expenses in connection with attendance at meetings in accordance with Digi's policies) until such time as the Executive shall become an Outside Director of Digi (as defined in Digi's 2000 Omnibus Stock Plan), at which time he will be entitled to receive compensation from Digi as an Outside Director generally applicable to other Outside Directors. The Executive shall perform his services under this Agreement primarily from his home office and at such locations as may be required by the Company from time to time, but the Company will not require the Executive to permanently relocate to an office more than 50 miles from the Company's Waltham, Massachusetts, office. The Company shall pay or reimburse the Executive for all reasonable business expenses associated with maintaining his home office.

(c) The Executive agrees to comply with the policies and procedures of the Company applicable to its U.S. employees generally from time to time that are in force (which may be amended, revised or supplemented at any time in the Company's and/or the Company's Board of Directors' ("Company's BOD") sole discretion), provided, however, that to the extent there is a conflict between the terms of this Agreement and the policies and procedures of the Company, the terms of this Agreement shall govern unless otherwise specified herein.

3) Compensation and Benefits. During the term of this Agreement, the Company shall pay the Executive as compensation for his performance of his duties and obligations hereunder, the following:

(a) Base Salary. During the Term, the Company shall pay to the Executive a base salary at the rate of U.S. $20,833.33 per month ("Base Salary"), subject to annual increase at the discretion of the Digi's BOD's Compensation Committee ("Digi Compensation Committee") in accordance with Digi's executive compensation practices, and payable in accordance with the regular payroll practices of the Company as may be modified or established from time to time.

(b) Incentive Compensation. During the Term, the Executive shall be eligible to receive additional annual incentive compensation (the "Incentive Bonus"). The amount of the Incentive Bonus, if any, shall be $125,000 provided the Digi Compensation Committee has determined that the Executive has attained certain goals established by the Digi Compensation Committee. The Digi Compensation Committee may consider, among other things, the Executive's actual attainment of specific goals as established by the Digi Compensation Committee, and Digi's and/or the Company's overall performance. The Digi Compensation Committee will make all determinations regarding the Executive's eligibility for the annual Incentive Bonus at its sole discretion. Subject to the provisions of Section 4 herein, the Executive must be employed by the Company in good standing (as determined by Digi's BOD) to be eligible for any Incentive Bonus payments, which will be subject to applicable taxes and payable in accordance with the Company's normal bonus pay practices as may be established or modified from time to time.

(c) Stock options.

(i) Digi shall upon consummation of the Merger and pursuant to the Merger Agreement, assume all of the Executive's outstanding stock options to purchase shares of the Company's stock, which shares shall be exercisable for shares of Digi's common stock, and Digi shall file a Registration Statement on Form S-8 to register the Digi shares to be issued pursuant to such options.

(ii) Upon consummation of the Merger, Executive's unvested stock options shall vest immediately and all of the Executive's stock options shall remain in full force and effect and may be exercised at any time up to their latest possible date of expiration as set out in each stock option agreement entered into between the Executive and the Company and applicable to such options (such option agreements existing as of the date of this Agreement and the latest possible date of expiration of the option contained in each such option agreement as of the date of this Agreement are identified in Exhibit A hereto) notwithstanding any provision contained in any existing or future stock option agreement entered into between the Executive and the Company (as such agreements may be amended from time to time) or in the Company's Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (as amended from time to time) or the Company's 2001 Stock Option and Incentive Plan (as amended from time to time) that provides for either a lesser period of time within which to exercise such options or forfeiture of any option granted thereunder. In the event that any date of expiration contained in any existing or future stock option agreement entered into between the Executive and the Company shall be extended to a later date in time, then the Executive's right to exercise options pursuant to such stock option agreement shall be extended to that later date in time.

(iii) The Executive shall be eligible to receive additional stock option awards as determined by Digi's Compensation Committee in its sole discretion.

(d) Benefits. Subject to any contribution therefor generally required of senior executives of the Company, the Executive shall be eligible to participate in all employee benefits plans, including the Company's health and dental plans, as adopted by the Company's BOD and in effect for senior Company executives. Such participation shall be subject to (i) the terms of the applicable plan documents, (ii) generally applicable Company policies, and (iii) the discretion of the Company's BOD or any administrative or other committee provided for in or contemplated by such plans.

(e) Expenses. The Company shall pay or reimburse the Executive for all reasonable business expenses incurred or paid by the Executive in the performance of his responsibilities hereunder in accordance with the Company's prevailing policy and practice relating to reimbursements as established, modified or amended from time to time. The Executive must provide substantiation and documentation of these expenses to the Company in order to receive reimbursement, as required pursuant to Company policy.

(f) Vacation. The Executive shall be entitled to accrue up to four (4) weeks of vacation per calendar year, to be taken and paid in accordance with Company policy.

4) Termination of Employment.

(a) Termination by the Company for Cause. The Company may terminate the Executive's employment and this Agreement for Cause (as defined in Section 8(a)) upon written notice to the Executive and expiration of any cure periods as set forth in Section 8(a). In the event of termination for Cause, the Executive shall be entitled to no payments, salary continuation or other benefits, except for:

(i) Base Salary earned and accrued but unpaid through the date of Executive's termination of employment;

(ii) any Incentive Bonus payment, as determined by the Digi Compensation Committee pursuant to Section 3(b) herein, for the year previously ended prior to the Executive's termination. In addition, in its sole discretion, the Digi Compensation Committee may provide an additional incentive bonus payment for the year in which the Executive's termination of employment occurred;

(iii) payment for accrued but unused vacation time up to the Executive's termination of employment;

(iv) statutory benefit continuation rights in accordance with the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), provided Executive makes the appropriate voluntary contribution payments and subject to applicable law and the requirements of the Company's health insurance plans then in effect; and

(v) all expenses reimbursable to the Executive and unpaid as of the date of Executive's termination of employment.

(b) Termination Due to Death or Permanent Disability. In the event of the termination of the Executive's employment and this Agreement due to the Executive's death or Disability (as defined in Section 8(c)), the Executive, or the Executive's legal representative, shall be entitled to no payments, salary continuation or other benefits, except for:

(i) Base Salary to the extent earned and accrued but unpaid through the date of Executive's termination of employment, as well as a one-time lump-sum cash payment equivalent to the Executive's monthly Base Salary multiplied by the number of months remaining in the then-current Term of this Agreement, to be paid within a reasonable time, not to exceed ninety (90) days, after the Executive's death or Disability, subject to any offset or reduction as set forth in Section 4(b)(iv);

(ii) any Incentive Bonus payment, as determined by the Digi Compensation Committee pursuant to Section 3(b) herein, for the year previously ended prior to the Executive's termination. In addition, in its sole discretion, the Digi Compensation Committee may provide an additional incentive bonus payment for the year in which the Executive's termination of employment occurred;

(iii) payment for accrued but unused vacation time up to the Executive's termination of employment;

(iv) all benefits the Executive would otherwise receive upon a Disability or upon death under any benefit plan covering the Executive, provided, however, that all such benefits that the Executive receives or would otherwise receive upon a Disability shall be offset against any other payments under Section 4(b)(i) of this Section 4(b), such that any amount potentially owing to the Executive under Section 4(b)(i) is reduced, but not less than zero, by the monetary value of the benefits (referenced in this subsection) received by the Executive;

(v) statutory benefit continuation rights in accordance with COBRA, provided Executive makes the appropriate voluntary contribution payments and subject to applicable law and the requirements of the Company's health insurance plans then in effect;

(vi) all expenses reimbursable to the Executive and unpaid as of the date of Executive's termination of employment; and

(vii) the Executive's unvested stock options shall vest immediately and all of the Executive's stock options shall remain in full force and effect and may be exercised at any time up to their latest possible date of expiration as set out in each stock option agreement entered into between the Executive and the Company and applicable to such options (such option agreements existing as of the date of this Agreement and the latest possible date of expiration of the option contained in each such option agreement as of the date of this Agreement are identified in Exhibit A hereto) notwithstanding any provision contained in any

existing or future stock option agreement entered into between the Executive and the Company (as such agreements may be amended from time to time) or in the Company's Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (as amended from time to time) or the Company's 2001 Stock Option and Incentive Plan (as amended from time to time) that provides for either a lesser period of time within which to exercise such options or forfeiture of any option granted thereunder. In the event that any date of expiration contained in any existing or future stock option agreement entered into between the Executive and the Company shall be extended to a later date in time, then the Executive's right to exercise options pursuant to such stock option agreement shall be extended to that later date in time.

During the Term, the Company shall maintain disability insurance policies, for which the Executive is eligible, comparable to the insurance policies for which the other senior executives of the Company are eligible.

(c) Termination Without Cause or Expiration of Term. In the event that the Executive's employment and this Agreement is terminated by the Company without Cause or upon the expiration of the Term, this Agreement shall expire and the Executive shall be entitled to no payments, salary continuation or other benefits, except for:

(i) a one-time lump-sum cash payment equivalent to the Executive's monthly Base Salary multiplied by the number of months remaining in the initial 18 month Term of this Agreement, to be paid within a reasonable time, not to exceed ninety (90) days, if, and only if, this Agreement is terminated by the Company without Cause or by the Executive for Good Reason in the initial 18 month Term;

(ii) the Incentive Bonus payment as provided in Section 3(b), prorated through the date of such termination by the Company or expiration of the Term as provided in this Section 4(c), regardless of whether or not the Executive has attained the goals established by the Company's Compensation Committee;

(iii) payment for accrued but unused vacation time up to the Executive's termination of employment;

(iv) all expenses reimbursable to the Executive and unpaid as of the date of Executive's termination of employment;

(v) if the Executive elects after the termination of his employment and in accordance with COBRA to continue health coverage under the same plans available to active Company employees, under the same rules, restrictions and regulations applicable thereto, the Company shall make premium payments on his behalf until the earlier of (x) eighteen (18) months from the last day of the Executive's employment or (y) the date on which the Executive becomes ineligible to receive COBRA benefits ("COBRA Coverage"); provided that when the COBRA Coverage concludes, the Company shall reimburse the Executive for the cost of the Executive obtaining a medicare supplement policy for both the Executive and his

spouse, equivalent to the Blue Cross of New England's Medex Gold policy, from the date on which the COBRA Coverage concludes and terminating for each of the Executive and his spouse when they respectively attain the age of 80 years. The Executive shall be responsible for obtaining Medicare Part A, Medicare Part B and the individual Medicare supplement policy and shall be responsible for any premiums associated with either Medicare part A or Part B for both himself and his spouse. In addition, the Company shall reimburse the Executive in an amount equal to the reasonable cost of the Executive obtaining a dental insurance policy for himself and his spouse until each of the Executive and his spouse respectively attain the age of 80 years. The Executive shall be responsible for obtaining the dental insurance policies. Any time after the period ending five years from the date the COBRA Coverage concludes, the Company may elect to pay a one-time lump-sum payment for the insurance policies instead of continuing to reimburse the Executive as provided above. The one-time lump-sum payment will be in an amount equal to the then current premium payments of the policies held by the Executive and his spouse, indexed for inflation for the years remaining until each of the Executive and his spouse attains the age of 80 years (using the average of the past three years' annual Consumer Price Index for Boston Medical Care) and then discounted to the present value using the then current prime rate; and

(vi) the Executive's unvested stock options shall vest immediately and all of the Executive's stock options shall remain in full force and effect and may be exercised at any time up to their latest possible date of expiration as set out in each stock option agreement entered into between the Executive and the Company and applicable to such options (such option agreements existing as of the date of this Agreement and the latest possible date of expiration of the option contained in each such option agreement as of the date of this Agreement are identified in Exhibit A hereto) notwithstanding any provision contained in any existing or future stock option agreement entered into between the Executive and the Company (as such agreements may be amended from time to time) or in the Company's Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (as amended from time to time) or the Company's 2001 Stock Option and Incentive Plan (as amended from time to time) that provides for either a lesser period of time within which to exercise such options or forfeiture of any option granted thereunder. In the event that any date of expiration contained in any existing or future stock option agreement entered into between the Executive and the Company shall be extended to a later date in time, then the Executive's right to exercise options pursuant to such stock option agreement shall be extended to that later date in time.

(d) Voluntary Termination. The Executive may voluntarily terminate his employment only upon sixty (60) days' written notice to the Company's BOD ("Voluntary Termination"). In the event of a Voluntary Termination, the Company may accelerate Executive's departure date (and terminate this Agreement) and will have no obligation to pay Executive after his actual departure date. In the event of a Voluntary Termination, the Executive shall be entitled to no payments, salary continuation, or other benefits, except for (i) those payments and benefits as set forth in Section 4(a) and (ii) any of the

Executive's stock options due to vest within sixty (60) days of the Executive's written notice of Voluntary Termination to the Company's BOD, which shall vest immediately.

(e) Termination by the Executive for Good Reason. In the event the Executive decides to terminate this Agreement and his employment for Good Reason (as defined in Section 8(e)), the Executive must give notice of such Good Reason to the Company and the Company's BOD. If the basis for such Good Reason is not cured (as determined by the Company's BOD in good faith) within thirty (30) days after the Company and the Company's BOD receive written notice specifying the basis of such Good Reason, this Agreement, and the Executive's employment, shall terminate. In the event of a termination by the Executive for Good Reason, the Executive shall be entitled to the payments and benefits as set forth in Section 4(c).

(f) Execution of Release of Claims. In order to receive any of the payments and benefits outlined in Section 4(b), 4(c) or 4(e), as the case may be, the Executive must execute a comprehensive release of all claims in favor of the Company and its officers, directors, employees, shareholders, agents and/or representatives.

(g) Cessation of Payments and Benefits. If the Company's BOD in good faith determines that the Executive breached in any material respect his obligations under this Agreement or the Nondisclosure Agreement, the Company may immediately cease payment of all payments and/or benefits described in this Agreement. This cessation of payments and/or benefits shall be in addition to, and not as an alternative to, any other remedies in law or in equity available to the Company, including the right to seek specific performance or an injunction.

5) Change of Control. In the event of a Change of Control, the Executive's unvested stock options shall vest immediately and all of the Executive's stock options shall remain in full force and effect and may be exercised at any time up to their latest possible date of expiration as set out in each stock option agreement entered into between the Executive and the Company and applicable to such options (such option agreements existing as of the date of this Agreement and the latest possible date of expiration of the option contained in each such option agreement as of the date of this Agreement are identified in Exhibit A hereto) notwithstanding any provision contained in any existing or future stock option agreement entered into between the Executive and the Company (as such agreements may be amended from time to time) or in the Company's Amended and Restated 1998 Incentive and Non-Qualified Stock Option Plan (as amended from time to time) or the Company's 2001 Stock Option and Incentive Plan (as amended from time to time) that provides for either a lesser period of time within which to exercise such options or forfeiture of any option granted thereunder. In the event that any date of expiration contained in any existing or future stock option agreement entered into between the Executive and the Company shall be extended to a later date in time, then the Executive's right to exercise options pursuant to such stock option agreement shall be extended to that later date in time.

6) Certain Additional Payments by the Company. If any payment or benefit to which the Executive (or any person on account of the Executive) is entitled, whether under this Agreement or otherwise (a "Payment") constitutes a "parachute payment" within the

meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), and as a result thereof the Executive is subject to a tax under Section 4999 of the Code, or any successor thereto (an "Excise Tax"), the Company shall pay to the Executive an additional amount, which is intended to make the Executive whole for payment of such Excise Tax (the "Gross-Up Amount"). The Gross-Up Amount shall be equal to the amount of the Excise Tax (including the aggregate amount of any interest, penalties, fines or additions imposed in connection with the imposition of such Excise Tax), plus all income, excise and other applicable taxes imposed on the Executive under the laws of any Federal, state of local government or taxing authority by reason of the payments required under this Section 6.

(a) For purposes of determining the Gross-Up Amount, the Executive shall be deemed to be taxed at the highest marginal rate under all applicable local, state and federal income tax laws for the year in which the Gross-Up Amount is paid. The Gross-Up Amount shall be paid by the Company coincident with the Payment to which the Excise Tax relates.

(b) All calculations under this Section 6, including whether and when a Gross-Up Amount is required to be paid and the amount of such Gross-Up Amount and the assumptions to be utilized in arriving at such calculations, shall be made by a nationally recognized public accounting firm as shall be jointly designated by the Executive and the Company (the "Accounting Firm"). The Accounting Firm shall provide detailed supporting calculations both to the Company and to the Executive. All fees and expenses of the Accounting Firm shall be borne by the Company. The determination of the Accounting Firm shall be conclusive on the Company and the Executive unless the Internal Revenue Service, a court of competent jurisdiction or such other duly empowered governmental body or agency (a "Tax Authority") determines that the Executive owes a greater or lesser amount of Excise Tax with respect to any Payment than the amount determined by the Accounting Firm.

(c) If a Tax Authority makes a claim against the Executive which, if successful, would require the Company to pay a greater Gross-Up Amount under this Section 6, the Executive agrees to contest the claim on request of the Company with counsel jointly chosen by the Executive and the Company, subject to the following conditions:

(i) The Executive shall notify the Company of any such claim promptly after becoming aware thereof. In the event that the Company desires the claim to be contested, it shall promptly (but in no event more than thirty (30) days after the notice from the Executive or such shorter time as the Tax Authority may specify for responding to such claim) request the Executive to contest the claim.

(ii) If the Company so request that the Executive contest the claim, the Executive will, at the direction of the Company, either pay the tax claimed and sue for a refund in the appropriate court, or contest the claim in the United States Tax Court or other appropriate court, provided, however, that any request by the Company for the Executive to pay the tax bill shall be accompanied by an advance from the Company to the Executive of funds sufficient to make the requested payment plus any amounts

payable under this Section 6 determined as if such advance were a Gross-Up Amount. The Executive agrees to cooperate in good faith with the Company in contesting the claim and to comply with any reasonable request from the Company concerning the contest of the claim. The Company shall be liable for and indemnify the Executive against any loss in connection with, and all costs and expenses, including reasonable attorneys' fees, which may be incurred as a result of contesting the claim, and shall provide to the Executive cash advances for all such costs and expenses reasonably expected to be incurred by the Executive as a result of contesting the claim.

(d) Should a Tax Authority finally determine that an additional Excise Tax is owed, then the Company shall pay an additional Gross-Up Amount to the Executive including any assessment of interest, fines or penalties in accordance with this Section 6. Should a Tax Authority finally determine that the Executive is entitled to a refund, the Executive shall promptly pay to the Company the amount of such refund.

7) Consideration. In addition to the other benefits provided to the Executive in this Agreement, the Company shall pay $10,000 to the Executive upon the execution of this Agreement as consideration for his entering into this Agreement.

8) Definitions.

For purposes of the Agreement, the following terms shall be defined as set forth below:

(a) "Cause," which will be determined by the Digi Compensation Committee in good faith and at its sole discretion, is defined as:

(i) the continued failure or refusal of the Executive substantially to perform Executive's duties and obligations to the Company (other than any such failure resulting from the Executive's Disability) and which is not cured within fifteen (15) days of notice thereof from the Company;

(ii) gross negligence in the performance of the Executive's duties, willful misfeasance in connection with the Executive's work, dishonesty, disloyalty, or a breach of fiduciary duty by the Executive;

(iii) the commission by the Executive of an act of fraud, embezzlement, misappropriation of any money or other assets or property (whether tangible or intangible), or any other illegal conduct in connection with the Executive's performance of his duties;

(iv) the Executive's conviction of or pleading of nolo contendere to a felony;

(v) disregard in any material respect of the rules or policies of the Company, which, if curable, has not been cured within fifteen (15) days after notice thereof from the Company;

(vi) engagement by the Executive in misconduct which is injurious in any material respect to the Company; or

(vii) the commission of an act which constitutes unfair competition with the Company or which induces any customer of the Company to breach a contract with the Company, or the Executive's material breach of this Agreement, the Nondisclosure Agreement, or any other written agreement with the Company.

(b) "Change of Control" means: (i) the merger or consolidation of Digi with or into any other corporation or entity, or the merger or consolidation of any other corporation or entity into or with Digi, which results in Digi's or those persons who are shareholders of Digi from and after the Effective Time holding less than 50% in voting power of the outstanding capital stock of the surviving corporation; (ii) any sale or transfer in a single transaction or series of related transactions of all or substantially all of Digi's assets as of the transaction date (or the date of the first transaction in a series of related transactions); (iii) a third "person," including a "group," becomes the "beneficial owner" (as these terms are defined in Section 13(d) of the Securities Exchange Act of 1934, as amended) of shares of Digi having more than 50% of the voting power of the outstanding capital stock of Digi; or (iv) any transaction or series of related transactions in which a third "person," including a "group" (as these terms are defined in Section 13(d) of the Securities Exchange Act of 1934, as amended), appoints or elects a majority of the Board of Directors of Digi.

(c) "Disability" means the Executive's inability, for a period of ninety (90) consecutive days, to perform, with or without a reasonable accommodation (that does not subject the Company to an undue hardship), the essential functions of his position by reason of mental or physical impairment.

(d) "Voluntary Termination" means a termination of employment during the Term by the Executive on the Executive's own initiative other than a termination for death or Disability under Section 4(b).

(e) "Good Reason" shall mean, without the Executive's approval,

(i) a material diminution, without Cause (as defined in Section 8(a)), in the material responsibilities of the Executive;

(ii) Executive's permanent relocation to an office more than 50 miles from the Company's Waltham, Massachusetts office;

(iii) failure by the Company to pay any material amount due under this Agreement within fifteen (15) days after written notice thereof from the Executive to the Company and the Company's BOD; or

(iv) any reduction of the Executive's Base Salary or material benefits provided to the Executive as a whole that comprises a material reduction in his total annual compensation, unless such reduction is applicable to other senior executives of the

Company as part of a concessionary arrangement between those executives and the Company and/or the Company's BOD.

9) Noncompetition and Nonsolicitation. As a condition of this Agreement, and in consideration for the payments set forth herein, the Executive agrees that, during the period of his employment by the Company, Digi and their subsidiaries and for three (3) years after the termination of his employment for any reason (except for termination without Cause or termination for Good Reason), the Executive shall not:

(a) directly or indirectly, individually or on behalf of any other person or entity, for any person or entity, engage in the marketing or sale of Competitive Products or Services (defined below) to persons or entities: (i) whom the Executive has called upon or contacted, or from whom the Executive has solicited business, as an employee of the Company; (ii) located in any sales territory that the Executive has covered or supervised with the Company; or (iii) for whom the Executive directly or indirectly prepared proposals or sales plans on behalf of the Company;

(b) directly or indirectly work as an employee, independent contractor, consultant, partner, or in any other capacity, with any entity engaged in the business of manufacturing, marketing and/or selling Competitive Products or Services if that entity is directly or indirectly owned or controlled, in whole or in part, by any former employee of the Company whose employment with the Company terminated at any time during: (i) the six months preceding the Executive separation of employment with the Company; or (ii) the twelve months following the Executive separation of employment with the Company;

For purposes of this provision, Competitive Products or Services means any product or service that is being designed, developed, manufactured, marketed or sold by anyone other than the Company and is of the same general type, performs similar functions or is used for the same purposes as, and, in each case, is directly or indirectly competitive with, a product or service of the Company and/or its parent corporation

(c) directly or indirectly, individually or in collaboration with others solicit, induce, recruit or encourage any of the Company's employees to leave their employment, or take away such employees, or attempt to solicit, induce, recruit, encourage or take away employees of the Company, either for the Executive or any other person or entity;

(d) divert or attempt to divert from the Company any business the Company had enjoyed or solicited from its customers or potential customers during the eighteen (18) months prior to the termination of employment.

(e) If any of the provisions in this Section 9 are overbroad and legally unenforceable as written, the parties agree that such provisions shall be narrowed and construed in a manner to render them enforceable to the maximum extent possible under applicable

law. If any of the provisions in this Section 9 are deemed legally void, the remaining provisions will nevertheless continue in full force and effect.

(f) The Executive hereby acknowledges that the provisions of this Section 9 are fair and reasonably necessary in order to protect the goodwill and business interest of the Company, which business interest and goodwill has been developed over many years at a substantial cost and expense to the Company, and that the terms and conditions hereof are not unreasonable as to time, limitation, or purpose. The Executive also acknowledges that the provisions of this Section 9 will not prevent him from engaging in a wide range of activities for the purpose of earning a living.

(g) In the event that the Executive shall violate the provisions of this Section 9, the Company shall have the legal right to seek an injunction, or other equitable relief, compelling the Executive to comply with the terms of this Section 9. In addition, the Company may seek any and all other legal remedies or relief permitted by law, including compensatory damages resulting from any breach.

10) Confidential Information.

(a) The Executive agrees at all times during the term of his employment and thereafter, to hold in strictest confidence, and not to use or disclose, except for the benefit of the Company, to any person, firm or corporation without written authorization of the Chief Executive Officer of the Company, any Confidential Information of the Company. The Executive understands that "Confidential Information" means any Company proprietary information, technical data, trade secrets or know-how, including, but not limited to, research and research plans, product plans, products, services, customer lists and customers (including, but not limited to, customers of the Company on whom the Executive called or with whom the Executive became acquainted during the term of his employment), markets, software, means of accessing the company's computer systems or networks, developments, inventions, processes, formulas, technology, designs, drawings, engineering data, hardware configuration information, marketing, financial or other business information obtained by me either directly or indirectly in writing, orally or by observation. The Executive further understands that Confidential Information does not include any of the foregoing items which has become publicly known and made generally available through no wrongful act of the Executive or of others who were under confidentiality obligations as to the item or items involved or improvements or new versions thereof.

(b) The Executive agrees that he will not, during his employment with the Company, improperly use or disclose any proprietary information or trade secrets of any former or concurrent employer or other person or entity and that he will not bring onto the premises of the Company any unpublished document or proprietary information belonging to any such employer, person or entity unless consented to in writing by such employer, person or entity.

(c) The Executive recognizes that the Company has received and in the future will receive from third parties their confidential or proprietary information subject to a duty on the Company's part to maintain the confidentiality of such information and to use it only for certain limited purposes. The Executive agrees to hold all such confidential or proprietary information in the strictest confidence and not to disclose it to any person, firm or corporation or to use it except as necessary in carrying out the Executive's work for the Company consistent with the Company's agreement with such third party.

11) Indemnification. The Executive shall be entitled to indemnification from the Company to the fullest extent permitted by the Company's Articles of Organization, By-laws, shareholder resolutions and/or applicable law.

12) Entire Agreement; Conflicts. This Agreement, the Nondisclosure Agreement, any stock option agreement between the Executive and the Company, and all promissory notes between the Executive and the Company, contain the entire agreement between the Company and the Executive concerning the Executive's employment by the Company and supersedes all prior agreements, understandings, discussions, negotiations and undertakings, whether written or oral, between them with respect to the subject matter herein, provided, however, that to the extent there is a conflict between the terms of this Agreement and the Nondisclosure Agreement or the terms of any stock option agreement or stock option plan, the terms of this Agreement shall govern. The Executive and the Company (except as may be required in the course of the Company doing business) agree to keep the terms of this Agreement strictly confidential. The Executive represents that he is not bound by any agreement or any other existing or previous business relationship that conflicts with, or may conflict with, the performance of his obligations hereunder or prevent the full performance of his duties and obligations hereunder.

13) Amendments or Waiver. This Agreement cannot be changed, modified or amended without the consent in writing of both the Executive and the Company's BOD, with the written consent of the Digi Compensation Committee. No waiver by either the Company or the Executive at any time of any breach by the other party of any condition or provision of this Agreement shall be deemed a waiver of a similar or dissimilar condition or provision at the same or at any prior or subsequent time. Any waiver must be in writing and signed by the Executive, an authorized officer of the Company (other than the Executive), and the Company's BOD, with the written consent of the Digi Compensation Committee.

14) Severability. In the event that any provision or portion of this Agreement, the Nondisclosure Agreement or the other agreements executed in connection with the transactions contemplated hereby for any reason shall be determined to be invalid or unenforceable for any reason, in whole or in part, such provisions will be reformed to the extent possible so as to effectuate the intent of this Agreement. In addition, the remaining provisions of this Agreement or such other agreements shall be unaffected thereby and shall be construed, reformed and thus remain in full force and effect to the fullest extent permitted by law.

15) Survival. The Executive agrees that Sections 4, 5, 6, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18 and 19, any agreements between the Executive and the Company referenced herein, and

such other provisions to the extent necessary to the intended preservation of such rights and obligations, shall survive any termination of this Agreement.

16) Governing Law and Jurisdiction; Arbitration. This Agreement shall be governed by and construed and interpreted in accordance with the laws of the Commonwealth of Massachusetts without reference to principles of conflict of laws. Any dispute, controversy or claim arising out of or in connection with this Agreement shall be exclusively subject to arbitration before the American Arbitration Association ("AAA") in Boston, Massachusetts, before a single arbitrator in accordance with the AAA's then current Employment Arbitration Rules. Judgment upon any arbitration award may be entered in any court of competent jurisdiction. All parties shall cooperate in the process of arbitration for the purpose of expediting discovery and completing the arbitration proceedings. Nothing contained in this Section or elsewhere in this Agreement shall in any way deprive either party of its right to obtain injunctive or other equitable relief in a court of competent jurisdiction.

17) Notices; Miscellaneous.

(a) Any notice given to either party shall be in writing and shall be deemed to have been given when delivered personally or sent by certified or registered mail, postage prepaid, return receipt requested, duly addressed to the party concerned, as follows:

If to the Company, to:

**[_______]
**[_______]
**[_______]
Attention: Chief Executive Officer

with a copy to:

Faegre & Benson LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402-3901
Attention: James E. Nicholson

If to the Executive, to:

c/o Taylor, Ganson & Perrin, LLP
160 Federal Street
Boston, MA 02110
Attention: Charles F. O'Connell

(b) The headings of the Sections contained in this Agreement are for convenience only and shall not be deemed to control or affect the meaning or construction of any provision of this Agreement.

(c) This Agreement may be executed in two or more counterparts.

(d) The Company shall make such deductions and withhold such amounts from the payments and benefits made or provided to the Executive hereunder, as may be required from time to time by applicable law, governmental regulation or order.

18) Assignment; Successors. The Company may assign this Agreement. This Agreement is personal in its nature and therefore the Executive cannot assign this Agreement without the consent of the Company's BOD. This Agreement will inure to the benefit of the Company's or the Executive's successors and assigns, and such successor or assign shall discharge and perform all the promises, covenants, duties and obligations of the Company hereunder, and all references herein to "Company" shall refer to such successor.

19) Withholding.

(a) Any payments made to the Executive pursuant to this Agreement (including without limitation the acceleration of options pursuant to this Agreement) shall be subject to all applicable federal, state and local taxes and/or withholding.

(b) If the Company in its discretion determines that it is obligated to withhold any tax in connection with any payment under this Agreement, or in connection with the acceleration of any option pursuant to this Agreement, the Executive hereby agrees that the Company may withhold from any amounts paid, or to be paid, under this Agreement, including the Executive's wages or other remuneration, the appropriate amount of such tax (as permitted under applicable law). The Executive further agrees that, if the Company does not withhold an amount from the Executive's wages or other remuneration (including any remuneration paid pursuant to this Agreement) sufficient to satisfy the withholding obligation of the Company, the Executive will make reimbursement on demand, in cash, for the amount underwithheld.

* * * * *

[Signature page to follow.]

IN WITNESS WHEREOF, the parties hereto have executed this Second Amended and Restated Employment Agreement as of the date first above written as an instrument under seal.

NETSILICON, INC.

By: /s/ Daniel J. Sullivan

Its: Chief Financial Officer

EMPLOYEE

/s/ Cornelius Peterson

Cornelius Peterson, VIII

The undersigned hereby consents to the terms of this Second Amended and Restated Employment Agreement.

DIGI INTERNATIONAL INC.

By: /s/ Subramanian Krishnan

Its: Chief Financial Officer

Exhibit A
To
Second Amended and Restated Employment Agreement
Between
NetSilicon, Inc. and Cornelius Peterson, VIII

Stock Option Agreements between NetSilicon, Inc. and Cornelius Peterson, VIII

Grant ID	Agreement Date	Expiration Date
0078	September 15, 1999	September 15, 2009
0079	September 15, 1999	September 15, 2009
0320	May 11, 2000	May 11, 2010
0321	May 11, 2000	May 11, 2010
0524	December 11, 2000	December 11, 2010
0601	July 10, 2001	July 10, 2011