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

FORM 10-Q

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

For the quarterly period ended: December 31, 2006

OR

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

For the transition period from _____ to _____.

Commission file number: 0-17972

DIGI INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

41-1532464

(I.R.S. Employer Identification Number)

**11001 Bren Road East
Minnetonka, Minnesota**

(Address of principal executive offices)

55343

(Zip Code)

(952) 912-3444

(Registrant's telephone number, including area code)

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

On January 31, 2007, there were 25,148,046 shares of the registrant's \$.01 par value Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | Three months ended December 31, | |
|---|--|-----------|
| | 2006 | 2005 |
| | (in thousands, except per common share data) | |
| Net sales | \$ 41,811 | \$ 33,376 |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) | 18,650 | 14,010 |
| Amortization of purchased and core technology | 1,148 | 1,168 |
| Gross profit | 22,013 | 18,198 |
| Operating expenses: | | |
| Sales and marketing | 8,158 | 6,752 |
| Research and development | 5,972 | 4,815 |
| General and administrative | 3,578 | 3,753 |
| Total operating expenses | 17,708 | 15,320 |
| Operating income | 4,305 | 2,878 |
| Other income (expense): | | |
| Interest income | 796 | 417 |
| Interest expense | (25) | (41) |
| Other expense | — | (43) |
| Total other income, net | 771 | 333 |
| Income before income taxes | 5,076 | 3,211 |
| Income tax provision | 1,274 | 1,028 |
| Net income | \$ 3,802 | \$ 2,183 |
| Net income per common share: | | |
| Basic | \$ 0.15 | \$ 0.10 |
| Diluted | \$ 0.15 | \$ 0.09 |
| Weighted average common shares, basic | 25,078 | 22,781 |
| Weighted average common shares, diluted | 25,983 | 23,486 |

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

DIGI INTERNATIONAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | December 31, 2006 | September 30, 2006 |
|--|-----------------------------------|-----------------------|
| | (in thousands, except share data) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 21,468 | \$ 15,674 |
| Marketable securities | 40,005 | 43,207 |
| Accounts receivable, net | 19,773 | 20,305 |
| Inventories | 24,636 | 21,911 |
| Other | 6,320 | 5,528 |
| Total current assets | 112,202 | 106,625 |
| Property, equipment and improvements, net | 19,621 | 19,488 |
| Identifiable intangible assets, net | 29,553 | 31,341 |
| Goodwill | 65,941 | 65,841 |
| Other | 2,050 | 2,026 |
| Total assets | <u>\$ 229,367</u> | <u>\$ 225,321</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Capital lease obligations, current portion | \$ 378 | \$ 381 |
| Accounts payable | 7,557 | 6,748 |
| Income taxes payable | 5,933 | 4,712 |
| Accrued expenses: | | |
| Compensation | 3,771 | 5,851 |
| Other | 4,026 | 5,592 |
| Total current liabilities | 21,665 | 23,284 |
| Capital lease obligations, net of current portion | 625 | 725 |
| Net deferred tax liabilities | 7,559 | 7,482 |
| Total liabilities | <u>29,849</u> | <u>31,491</u> |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding | — | — |
| Common stock, \$.01 par value; 60,000,000 shares authorized; 27,804,591 and 27,748,640 shares issued and outstanding | 278 | 277 |
| Additional paid-in capital | 166,165 | 164,782 |
| Retained earnings | 50,811 | 47,009 |
| Accumulated other comprehensive income | 1,319 | 940 |
| Treasury stock, at cost, 2,694,045 and 2,711,496 shares | (19,055) | (19,178) |
| Total stockholders' equity | 199,518 | 193,830 |
| Total liabilities and stockholders' equity | <u>\$ 229,367</u> | <u>\$ 225,321</u> |

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

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

| | Three months ended December 31, | |
|---|---------------------------------|------------------|
| | 2006 | 2005 |
| | (in thousands) | |
| Operating activities: | | |
| Net income | \$ 3,802 | \$ 2,183 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation of property, equipment and improvements | 645 | 613 |
| Amortization of identifiable intangible assets and other assets | 1,947 | 1,907 |
| Excess tax benefits from stock-based compensation | (60) | (187) |
| Stock-based compensation | 765 | 531 |
| Deferred income taxes | 78 | (708) |
| Other | 289 | (143) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 657 | 543 |
| Inventories | (2,930) | (556) |
| Other assets | (776) | (365) |
| Accounts payable and accrued expenses | (2,444) | (2,800) |
| Income taxes payable | 1,179 | 1,252 |
| Net cash provided by operating activities | <u>3,152</u> | <u>2,270</u> |
| Investing activities: | | |
| Purchase of held-to-maturity marketable securities | (16,941) | (15,720) |
| Proceeds from maturities of held-to-maturity marketable securities | 20,143 | 11,111 |
| Contingent purchase price payments related to business acquisitions | (781) | — |
| Purchase of property, equipment, improvements and certain other intangible assets | (688) | (259) |
| Net cash provided by (used in) investing activities | <u>1,733</u> | <u>(4,868)</u> |
| Financing activities: | | |
| Payments on capital lease obligations and long-term debt | (103) | (143) |
| Excess tax benefits from stock-based compensation | 60 | 187 |
| Proceeds from stock option plan transactions | 515 | 1,684 |
| Proceeds from employee stock purchase plan transactions | 191 | 114 |
| Net cash provided by financing activities | <u>663</u> | <u>1,842</u> |
| Effect of exchange rate changes on cash and cash equivalents | 246 | (276) |
| Net increase (decrease) in cash and cash equivalents | 5,794 | (1,032) |
| Cash and cash equivalents, beginning of period | 15,674 | 12,990 |
| Cash and cash equivalents, end of period | <u>\$ 21,468</u> | <u>\$ 11,958</u> |

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

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

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

Basis of Presentation

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

The condensed consolidated financial statements presented herein reflect, in the opinion of management, all adjustments which consist only of normal, recurring adjustments necessary for a fair statement of the condensed consolidated financial position and the condensed consolidated results of operations and cash flows for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of results for the full year.

Recently Issued Accounting Pronouncements

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

2. COMPREHENSIVE INCOME

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

Comprehensive income was as follows (in thousands):

| | Three months ended December 31, | |
|--|------------------------------------|-----------------|
| | 2006 | 2005 |
| Net income | \$ 3,802 | \$ 2,183 |
| Foreign currency translation gain (loss) | 379 | (254) |
| Comprehensive income | <u>\$ 4,181</u> | <u>\$ 1,929</u> |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**3. NET INCOME PER COMMON SHARE**

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

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

| | <u>Three months ended December 31,</u> | |
|--|--|-----------------|
| | <u>2006</u> | <u>2005</u> |
| Numerator: | | |
| Net income | <u>\$ 3,802</u> | <u>\$ 2,183</u> |
| Denominator: | | |
| Denominator for basic net income per common share — weighted average shares outstanding | 25,078 | 22,781 |
| Effect of dilutive securities: | | |
| Employee stock options and employee stock purchase plan | 905 | 705 |
| Denominator for diluted net income per common share — adjusted weighted average shares outstanding | <u>25,983</u> | <u>23,486</u> |
| Net income per common share, basic | <u>\$ 0.15</u> | <u>\$ 0.10</u> |
| Net income per common share, diluted | <u>\$ 0.15</u> | <u>\$ 0.09</u> |

Potentially dilutive common shares related to stock options to purchase 562,613 and 1,365,513 common shares at December 31, 2006 and 2005, respectively were not included in the computation of diluted earnings per common share because the options' exercise prices were greater than the average market price of common shares and, therefore, their effect would be anti-dilutive.

4. STOCK-BASED COMPENSATION

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

The Stock Option Plan and the Non-Officer Plan include nonstatutory stock options (NSOs) and the Stock Option Plan also includes incentive stock options (ISOs) to employees and others who provide services to the Company, including consultants, advisers and directors. Options

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**4. STOCK-BASED COMPENSATION (CONTINUED)**

granted under these plans generally vest over a four year service period and will expire if unexercised after ten years from the date of grant. The exercise price for ISOs and non-employee director options granted under the Stock Option Plan is set at the fair market value of the Company's common stock based on the closing price on the date of grant. The exercise price for NSOs granted under the Stock Option Plan or the Non-Officer Plan is set by the Compensation Committee of the Board of Directors and is not less than 50% of the fair market value based on the closing price on the date of grant.

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

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

Also, the Company sponsors an Employee Stock Purchase Plan as Amended and Restated as of November 27, 2006 (the Purchase Plan), covering all domestic employees with at least 90 days of continuous service and who are customarily employed at least 20 hours per week. The Purchase Plan allows eligible participants the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. The Purchase Plan was ratified on January 22, 2007 at the Annual Meeting of Stockholders and provides for the issuance of up to 1,750,000 shares of Common Stock of the Company that may be purchased under the plan.

Effective October 1, 2005 the Company adopted Statement of Financial Accounting Standard No. 123 as amended, (FAS No. 123R), using the modified prospective method of application. Under this method, compensation expense is recognized both for (i) awards granted, modified or settled subsequent to September 30, 2005 and (ii) the nonvested portion of awards granted prior to October 1, 2005. Compensation expense recorded during the quarters ended December 31, 2006 and 2005 includes approximately \$0.5 million and \$0.1 million, respectively related to awards issued subsequent to September 30, 2005 and \$0.3 million and \$0.4 million, respectively, related to nonvested awards issued prior to October 1, 2005 using the intrinsic value method of accounting.

Stock-based compensation expense (pre-tax) is included in the consolidated results of operations for the three months ended December 31, 2006 and 2005 as follows (in thousands):

| | <u>Three months ended December 31,</u> | |
|--------------------------------|--|---------------|
| | <u>2006</u> | <u>2005</u> |
| Cost of sales | \$ 31 | \$ 20 |
| Sales and marketing | 219 | 126 |
| Research and development | 149 | 127 |
| General and administrative | 366 | 258 |
| Total stock-based compensation | <u>\$ 765</u> | <u>\$ 531</u> |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**4. STOCK-BASED COMPENSATION (CONTINUED)**

FAS 123R also requires that the excess windfall tax benefit resulting from the tax deductibility of the increase in the value of share-based arrangements be presented as a component of cash flows from financing activities in the Condensed Consolidated Statement of Cash Flows.

A summary of option activity under the Plans as of December 31, 2006 and changes during the three months then ended is presented below (in thousands, except per common share amounts):

| | <u>Available for Grant</u> | <u>Options Outstanding</u> | <u>Weighted Average Exercise Price per Common Share</u> | <u>Weighted Average Contractual Term (in years)</u> | <u>Aggregate Intrinsic Value</u> |
|----------------------------------|--------------------------------|--------------------------------|---|---|--|
| Balances, September 30, 2006 | 597 | 4,240 | \$ 10.54 | | |
| Granted | (485) | 485 | 13.42 | | |
| Exercised | — | (56) | 9.21 | | |
| Cancelled | <u>27</u> | <u>(27)</u> | 11.54 | | |
| Balances, December 31, 2006 | <u>139</u> | <u>4,642</u> | <u>\$ 10.85</u> | <u>5.66</u> | <u>\$ 16,070</u> |
| Exercisable at December 31, 2006 | | <u>3,425</u> | <u>\$ 10.19</u> | <u>4.46</u> | <u>\$ 14,579</u> |

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. The total intrinsic value of all options exercised during the quarter was \$0.3 million. The weighted average fair value of options granted during the three months ended December 31, 2006 was \$5.93 and was determined based upon the fair value of each option on the grant date, utilizing the Black-Scholes option-pricing model and the following assumptions:

| | |
|--------------------------------|---------------|
| Risk free interest rate | 4.44% - 4.65% |
| Expected option holding period | 4 - 5 years |
| Expected volatility | 48% - 52% |
| Weighted average volatility | 49% |
| Expected dividend yield | 0 |

The fair value of each option award granted during the periods presented was estimated using the Black-Scholes option valuation model that uses the assumptions noted in the table above. Expected volatilities are based on the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination information within the valuation model; separate groups of grantees that have similar historical exercise behaviors are considered separately for valuation purposes. The expected term of options granted is derived from the vesting period and historical information and represents the period of time that options granted are expected to be outstanding. The risk-free rate used is based on the zero-coupon U.S. Treasury bond rate in effect at the time of the grant whose maturity equals the expected term of the option. These rates have been converted to continuously compounded equivalent rates.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**4. STOCK-BASED COMPENSATION (CONTINUED)**

A summary of the Company's nonvested options as of December 31, 2006 and changes during the three months then ended is presented below (in thousands, except per common share amounts):

| | Number of Options | Weighted Average Grant Date Fair Value per Common Share |
|---------------------------------|----------------------|--|
| Nonvested at September 30, 2006 | 940 | \$ 5.33 |
| Granted | 485 | 5.93 |
| Vested | (188) | 3.13 |
| Forfeited | (20) | 4.97 |
| Nonvested at December 31, 2006 | <u>1,217</u> | \$ 5.92 |

The Company used historical data to estimate pre-vesting forfeiture rates. The pre-vesting forfeiture rate used in the first quarter of fiscal 2007 was 2.5%. As of December 31, 2006 the total unrecognized compensation cost related to nonvested stock-based compensation arrangements net of expected forfeitures was \$6.9 million and the related weighted average period over which it is expected to be recognized is approximately 3.0 years.

5. ACQUISITIONS**MaxStream, Inc.**

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

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

The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation resulted in goodwill of \$26.4 million and a charge of \$2.0 million for acquired in-process research and development. The Company believes that the acquisition resulted in the recognition of goodwill primarily because MaxStream's wireless technologies and products significantly expand

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**5. ACQUISITIONS (CONTINUED)**

Digi's wireless offering, covering both short and medium range distances using embedded modules and boxed/package solutions and provides the capability to provide our customers end-to-end wireless solutions.

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

| | Three months ended December 31, 2005 | |
|--------------------------------------|--------------------------------------|-------------|
| | Pro forma | As Reported |
| Net sales | \$ 36,609 | \$ 33,376 |
| Net income | \$ 2,211 | \$ 2,183 |
| Net income per common share, basic | \$ 0.09 | \$ 0.10 |
| Net income per common share, diluted | \$ 0.09 | \$ 0.09 |

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

6. SELECTED BALANCE SHEET DATA (in thousands)

| | December 31, 2006 | September 30, 2006 |
|--------------------------------------|----------------------|-----------------------|
| Accounts receivable, net: | | |
| Accounts receivable | \$ 20,409 | \$ 20,800 |
| Less allowance for doubtful accounts | 636 | 495 |
| | <u>\$ 19,773</u> | <u>\$ 20,305</u> |
| Inventories: | | |
| Raw materials | \$ 18,467 | \$ 16,491 |
| Work in process | 1,260 | 606 |
| Finished goods | 4,909 | 4,814 |
| | <u>\$ 24,636</u> | <u>\$ 21,911</u> |
| Other accrued expenses: | | |
| Product warranty accrual | \$ 964 | \$ 1,104 |
| Accrued professional fees | 630 | 879 |
| Other accrued expenses | 2,432 | 3,609 |
| | <u>\$ 4,026</u> | <u>\$ 5,592</u> |

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

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

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

| | December 31, 2006 | | | September 30, 2006 | | |
|--------------------------------|-----------------------|---------------|-----------|-----------------------|---------------|-----------|
| | Gross carrying amount | Accum. amort. | Net | Gross carrying amount | Accum. amort. | Net |
| Purchased and core technology | \$ 48,046 | \$(32,653) | \$ 15,393 | \$ 48,022 | \$(31,492) | \$ 16,530 |
| License agreements | 2,440 | (1,990) | 450 | 2,440 | (1,890) | 550 |
| Patents and trademarks | 7,704 | (3,103) | 4,601 | 7,608 | (2,837) | 4,771 |
| Customer maintenance contracts | 700 | (341) | 359 | 700 | (324) | 376 |
| Customer relationships | 11,512 | (2,762) | 8,750 | 11,470 | (2,356) | 9,114 |
| Total | \$ 70,402 | \$(40,849) | \$ 29,553 | \$ 70,240 | \$(38,899) | \$ 31,341 |

Amortization expense was \$1.9 million and \$1.8 million for the three months ended December 31, 2006 and 2005, respectively.

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

| | |
|--------------------|----------|
| 2007 (nine months) | \$ 5,644 |
| 2008 | 5,386 |
| 2009 | 4,036 |
| 2010 | 3,640 |
| 2011 | 3,072 |
| 2012 | 2,514 |

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

| | Three months ended December 31, | |
|---|---------------------------------|-----------|
| | 2006 | 2005 |
| Beginning balance, October 1 | \$ 65,841 | \$ 38,675 |
| Purchase price adjustment — FS Forth | — | (147) |
| Foreign currency translation adjustment | 100 | (33) |
| Ending balance, December 31 | \$ 65,941 | \$ 38,495 |

During the three months ended December 31, 2005, the purchase price of FS Forth, acquired in fiscal year 2005, was reduced as a result of a change in certain tax liabilities, as defined in the purchase agreement. A payment of \$0.8 million was made in October 2006 as contingent consideration based on the achievement of the milestones identified in the merger agreement. Future contingent consideration of up to \$1.2 million may be payable to FS Forth based upon the achievement of certain milestones (see Note 10).

8. INCOME TAXES

For the first quarter of fiscal 2007 income taxes have been provided at an effective rate of 25.1% compared to 32.0% for the first quarter of fiscal 2006. On December 9, 2006, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit that previously expired on December 31, 2005. As a result of the extension, the Company recorded a benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006. The additional

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

research and development credits were accounted for as a discrete event in the first quarter of fiscal 2007. The effective tax rates for both the first three months of fiscal 2007 and 2006 are lower than the U.S. statutory rate of 35.0% primarily due to the utilization of income tax credits and the combined phase-out of the extraterritorial income exclusion and the phase-in of the U.S. domestic production activities deduction.

The Company expects its annualized 2007 income tax rate to be approximately 33% to 33.5%.

9. FINANCIAL GUARANTEES

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

| | <u>Balance at October 1</u> | <u>Warranties issued (1)</u> | <u>Settlements made</u> | <u>Balance at December 31</u> |
|------|---------------------------------|----------------------------------|-----------------------------|-----------------------------------|
| 2006 | \$ 1,104 | \$ 85 | \$ (225) | \$ 964 |
| 2005 | \$ 1,187 | \$ (1) | \$ (118) | \$ 1,068 |

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

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

10. CONTINGENCIES*Contingent obligations*

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

Legal Proceedings

On April 19, 2002, a consolidated amended class action complaint was filed in the United States District Court for the Southern District of New York asserting claims relating to the initial public offering (IPO) of NetSilicon and approximately 300 other public companies. The complaint

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. CONTINGENCIES (CONTINUED)

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

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

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

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

If the proposed settlement is not consummated, the Company intends to continue to defend the litigation vigorously. The litigation process is inherently uncertain and unpredictable, however, there can be no guarantee as to the ultimate outcome of this pending lawsuit. The Company maintains liability insurance for such matters and expects that the liability insurance will be adequate to cover any potential unfavorable outcome, less the applicable deductible amount of \$250,000 per claim. As of December 31, 2006, the Company has accrued a liability for the deductible amount of \$250,000 which the Company believes reflects the amount of loss that is probable. In the event the Company has losses that exceed the limits of the liability insurance, such losses could have a material effect on the business, or consolidated results of operations or financial condition of the Company.

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

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

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

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

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

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

CRITICAL ACCOUNTING POLICIES

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

OVERVIEW

Digi operates in the communications technology industry, which is characterized by rapid technological advances and evolving industry standards. The market can be significantly affected by new product introductions and marketing activities of industry participants. Digi places a high priority on development of innovative products that provide differentiated features and functions and allow for ease of integration with customers’ applications. The Company competes for customers on the basis of existing and planned product features, company reputation, brand recognition, technical support, relationships with partners, quality and reliability, product development capabilities, price and availability.

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

OVERVIEW (CONTINUED)

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

The Company anticipates that growth in the future will result from both products that are developed internally as well as from products that are acquired, and that the growth rate from products developed internally will increase as the multi-port serial adapters and the network interface cards (NICs) near the end of their product life cycles.

- Net sales of \$41.8 million, for the three months ended December 31, 2006, represented an increase of \$8.4 million, or 25.3%, compared to net sales of \$33.4 million for the three months ended December 31, 2005.
- Gross profit margin decreased to 52.6% compared to 54.5% for the three months ended December 31, 2006 and 2005, respectively.
- Total operating expenses for the three months ended December 31, 2006 were \$17.7 million, or 42.3% of net sales, compared to \$15.3 million, or 45.9% of net sales, for the three months ended December 31, 2005, an increase of \$2.4 million or 15.6%.
- Net income increased \$1.6 million to \$3.8 million, or \$0.15 per diluted share, for the three months ended December 31, 2006, compared to \$2.2 million, or \$0.09 per diluted share for the three months ended December 31, 2005. As a result of the extension of the research and development credit for two additional years beyond calendar 2005, a benefit for research and development credits earned during the last three quarters of fiscal 2006 was recorded during the first quarter of fiscal 2007, resulting in an additional tax benefit of \$0.5 million or \$0.02 per diluted share.
- The Company's net working capital position (total current assets less total current liabilities) increased \$7.2 million to \$90.5 million during the three months ended December 31, 2006 and its current ratio was 5.2 to 1 as of that date. Cash and cash equivalents and marketable securities increased \$2.6 million to \$61.5 million during the period. At December 31, 2006, the Company had no debt other than capital lease obligations.

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

CONSOLIDATED RESULTS OF OPERATIONS

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

| | Three months ended December 31, | | | | % increase (decrease) |
|---|---------------------------------|--------|-----------|--------|--------------------------|
| | 2006 | | 2005 | | |
| Net sales | \$ 41,811 | 100.0% | \$ 33,376 | 100.0% | 25.3% |
| Cost of sales (exclusive of amortization of purchased and core technology shown separately below) | 18,650 | 44.6 | 14,010 | 42.0 | 33.1 |
| Amortization of purchased and core technology | 1,148 | 2.8 | 1,168 | 3.5 | (1.7) |
| Gross profit | 22,013 | 52.6 | 18,198 | 54.5 | 21.0 |
| Operating expenses: | | | | | |
| Sales and marketing | 8,158 | 19.5 | 6,752 | 20.2 | 20.8 |
| Research and development | 5,972 | 14.3 | 4,815 | 14.4 | 24.0 |
| General and administrative | 3,578 | 8.5 | 3,753 | 11.3 | (4.7) |
| Total operating expenses | 17,708 | 42.3 | 15,320 | 45.9 | 15.6 |
| Operating income | 4,305 | 10.3 | 2,878 | 8.6 | 49.6 |
| Interest income and other, net | 771 | 1.8 | 333 | 1.0 | 131.5 |
| Income before income taxes | 5,076 | 12.1 | 3,211 | 9.6 | 58.1 |
| Income tax provision | 1,274 | 3.0 | 1,028 | 3.1 | 23.9 |
| Net income | \$ 3,802 | 9.1% | \$ 2,183 | 6.5% | 74.2% |

NET SALES

Net sales for the three months ended December 31, 2006 were \$41.8 million compared to net sales of \$33.4 million for the three months ended December 31, 2005, or an increase of \$8.4 million or 25.3%. Net sales of products acquired as a result of the MaxStream acquisition were \$4.6 million in the first quarter of fiscal 2007.

The following summarizes the Company's net sales for the periods indicated:

| (\$ in thousands) | Three months ended December 31, | | | | Increase | % |
|-------------------|---------------------------------|--------|-----------|--------|----------|-------|
| | 2006 | | 2005 | | | |
| Non-embedded | \$ 25,166 | 60.2% | \$ 19,335 | 57.9% | \$ 5,831 | 30.2% |
| Embedded | 16,645 | 39.8 | 14,041 | 42.1 | 2,604 | 18.5 |
| Total net sales | \$ 41,811 | 100.0% | \$ 33,376 | 100.0% | \$ 8,435 | 25.3% |

The Company's non-embedded products net sales, including MaxStream product net sales, increased \$5.8 million or 30.2% for the three months ended December 31, 2006 compared to the three months ended December 31, 2005. Product introductions associated with net sales of network connected products, USB, cellular gateways and MaxStream non-embedded products increased net sales by \$6.1 million for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005. Multi-port serial adapter products net sales declined by \$0.3 million in the comparable three month periods described above as this product line continues to mature.

Embedded products net sales, including MaxStream product net sales, increased \$2.6 million or 18.5% for the three months ended December 31, 2006 compared to the three months ended December 31, 2005. Net sales of embedded modules and microprocessors increased net sales by \$3.8 million for the three months ended December 31, 2006 compared to the three months ended December 31, 2005, offsetting the decline of \$1.2 million of NIC net sales for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005. We expect sales of NICs to be less than 1% of quarterly net sales in the future since our OEM customers have migrated from NICs to software only solutions.

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

NET SALES (CONTINUED)

Fluctuation in foreign currency rates compared to the same period one year ago had a favorable impact on net sales of \$0.5 million in the three month period ended December 31, 2006 and an unfavorable impact on net sales of \$0.4 million in the three month period ended December 31, 2005.

GROSS PROFIT

Gross profit margin for the three months ended December 31, 2006 was 52.6% compared to 54.5% for the three months ended December 31, 2005. The decrease in gross profit margin was primarily due to lower sales of multi-port serial adapters and NICs with higher gross profit margins, as well as higher manufacturing expenses.

The Company anticipates that its gross profit margins will continue to be consistent with current levels, including amortization of purchased and core technology of 2.5% - 3%.

OPERATING EXPENSES

Total operating expenses for the three months ended December 31, 2006 were \$17.7 million, or 42.3% of net sales, compared with \$15.3 million, or 45.9% of net sales, for the three months ended December 31, 2005. The increase in operating expenses is attributable to the inclusion of operating expenses pertaining to MaxStream and variable compensation expenses related to the increase in revenue, partially offset by a reduction in legal fees compared to the first quarter of fiscal 2006. Operating expenses as a percent of net sales decreased by 3.6 percentage points, or 15.6%, in the first quarter of 2007 compared to the first quarter of 2006 as the Company continues to focus on controlling expenses while increasing revenue.

Sales and marketing expenses for the three months ended December 31, 2006 were \$8.1 million, or 19.5% of net sales, compared to \$6.8 million, or 20.2% of net sales for the three months ended December 31, 2005. The net increase in sales and marketing expenses of \$1.3 million is primarily due to increased ongoing expenses of \$0.7 million as the result of the acquisition of Maxstream in the fourth quarter of fiscal 2006 and \$0.6 million of salaries, commissions and other compensation related expenses.

Research and development expenses for the three months ended December 31, 2006 were \$6.0 million, or 14.3% of net sales, compared to \$4.8 million, or 14.4% of net sales for the three months ended December 31, 2005. The net increase in research and development expenses of \$1.2 million is due primarily to increased ongoing expenses of \$0.4 million as a result of the acquisition of MaxStream in the fourth quarter of fiscal 2006, an increase of \$0.4 million in compensation related expenses and an increase of \$0.4 million due to various chip development projects.

General and administrative expenses were \$3.6 million, or 8.5% of net sales, for the three months ended December 31, 2006 compared to \$3.8 million, or 11.3% of net sales for the three months ended December 31, 2005. The net decrease in general and administrative expenses of \$0.2 million was due primarily to decreased legal fees of \$0.7 million compared to the three months ended December 31, 2005, offset by increased ongoing expenses of \$0.4 million as a result of the MaxStream acquisition.

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

INTEREST INCOME AND OTHER, NET

Interest income and other, net was \$0.8 million for the three months ended December 31, 2006 compared to \$0.3 million for the three months ended December 31, 2005. The Company realized interest income on marketable securities and cash and cash equivalents of \$0.8 million and \$0.4 million for the three month periods ended December 31, 2006 and 2005, respectively, due to higher average interest rates in the first quarter of fiscal 2007 compared to the first quarter of fiscal 2006, and an increase in the average invested balance.

INCOME TAXES

For the three months ended December 31, 2006, income taxes have been provided at an effective rate of 25.1% compared to 32.0% for the three months ended December 31, 2005. On December 9, 2006, Congress passed H.R. 6111, the "Tax Relief and Health Care Act of 2006", which included an extension of the research credit previously expired on December 31, 2005. As a result of the extension, the Company recorded a benefit of \$0.5 million in the first quarter of fiscal 2007 for research and development credits earned during the last three fiscal quarters of 2006. The additional research and development credits were accounted for as a discrete event in the first quarter of fiscal 2007. The effective tax rates for both the first three months of fiscal 2007 and 2006 are lower than the U.S. statutory rate of 35.0% primarily due to the utilization of income tax credits and the combined phase-out of the extraterritorial income exclusion and the phase-in of the U.S. domestic production activities deduction.

The Company expects its annualized 2007 income tax rate to be approximately 33% to 33.5%.

LIQUIDITY AND CAPITAL RESOURCES

The Company has financed its operations principally with funds generated from operations. At December 31, 2006, the Company had cash, cash equivalents and marketable securities of \$61.5 million compared to \$58.9 million at September 30, 2006. The Company's working capital increased \$7.2 million to \$90.5 million at December 31, 2006 compared to \$83.3 million at September 30, 2006.

Net cash provided by operating activities was \$3.2 million and \$2.3 million for the three months ended December 31, 2006 and 2005, respectively. The increase in net cash provided by operating activities of \$0.9 million for the comparable three month periods ended December 31, 2006 and 2005 is primarily due to an increase in net income of \$1.6 million adjusted for non-cash expenses of \$1.7 million, primarily related to stock-based compensation and deferred income taxes, offset by a \$2.4 million usage of working capital resulting from increased inventory at December 31, 2006 due to additional material purchases and production builds in order to fulfill order demand.

Net cash provided by investing activities was \$1.7 million during the three months ended December 31, 2006 compared to net cash used by investing activities of \$4.9 million during the same period in the prior fiscal year. Net settlements of marketable securities were \$3.2 million during the three months ended December 31, 2006 compared to net purchases of marketable securities of \$4.6 million during the same period one year ago. Purchases of property, equipment, improvements and certain other intangible assets were \$0.7 million and \$0.3 million for the three months ended December 31, 2006 and 2005, respectively. During the three months ended December 31, 2006, the Company used \$0.8 million for contingent purchase price payments related to the FS Forth acquisition (see Note 10 to Condensed Consolidated Financial Statements).

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

The Company anticipates total fiscal 2007 capital expenditures to approximate \$2.6 million.

The Company generated \$0.7 million from financing activities during the three months ended December 31, 2006 compared to \$1.8 million during the same period a year ago, primarily as a result of proceeds from stock option and employee stock purchase plan transactions in both periods, and the reflection of cash provided by the excess tax benefits related to the exercise of stock options.

The 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 operations in the foreseeable future.

The following summarizes the Company's contractual obligations at December 31, 2006 (in thousands):

| | Payments due by fiscal period | | | | |
|------------------------------------|-------------------------------|---------------------|-----------|-----------|------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | Thereafter |
| Operating leases | \$6,716 | \$2,385 | \$2,343 | \$1,157 | \$831 |
| Capital leases | 1,177 | 449 | 728 | — | — |
| Total contractual cash obligations | \$7,893 | \$2,834 | \$3,071 | \$1,157 | \$831 |

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

RISK FACTORS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

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

FOREIGN CURRENCY RISK

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

For the three months ended December 31, 2006 and 2005, the Company had approximately \$14.2 million and \$14.1 million, respectively, of net sales to foreign customers including export sales, of which \$6.5 million and \$5.0 million, respectively, were denominated in foreign currency, predominantly Euros. In future periods, a significant portion of sales will continue to be made in Euros.

The average monthly exchange rate for the Euro to the U.S. Dollar increased approximately 8.3% from 1.1902 to 1.2891 and the average monthly exchange rate for the Japanese Yen to the U.S. Dollar remained at .0085 for the first quarter of fiscal year 2007 as compared to the same period one year ago. A 10.0% change from the first quarter fiscal 2007 average exchange rate for the Euro and Yen to the U.S. Dollar would have resulted in a 1.6% increase or decrease in net sales and a 1.1% increase or decrease in stockholders' equity. The above analysis does not take into consideration any pricing adjustments the Company may need to consider in response to changes in the exchange rate.

CREDIT RISK

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

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

ITEM 4. CONTROLS AND PROCEDURES (CONTINUED)

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES (CONTINUED)

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

| Exhibit No. | Description |
|-------------|--|
| 3(a) | Restated Certificate of Incorporation of the Company, as amended (1) |
| 3(b) | Amended and Restated By-Laws of the Company, as amended (2) |

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS (CONTINUED)

- 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(a) Digi International Inc. 2000 Omnibus Stock Plan as Amended and Restated effective as of November 27, 2006, as approved by stockholders on January 22, 2007
- 10(b) Digi International Inc. Employee Stock Purchase Plan, as Amended and Restated effective as of November 27, 2006, as approved by stockholders on January 22, 2007
- 31(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32 Section 1350 Certification

-
- (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)

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SIGNATURE

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

DIGI INTERNATIONAL INC.

Date: February 7, 2007

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

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EXHIBIT INDEX

| <u>Exhibit Number</u> | <u>Document Description</u> | <u>Form of Filing</u> |
|-----------------------|---|---------------------------|
| 3(a) | Restated Certificate of Incorporation of the Company, as Amended (incorporated by reference to the corresponding exhibit number to the Company's Form 10-K for the year ended September 30, 1993 (File No. 0-17972)) | Incorporated by Reference |
| 3(b) | Amended and Restated By-Laws of the Company (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(a) | Digi International Inc. 2000 Omnibus Stock Plan as Amended and Restated effective as of November 27, 2006, as approved by stockholders on January 22, 2007 | Filed Electronically |
| 10(b) | Digi International Inc. Employee Stock Purchase Plan, as Amended and Restated effective as of November 27, 2006, as approved by stockholders on January 22, 2007 | Filed Electronically |
| 31(a) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer | Filed Electronically |
| 31(b) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer | Filed Electronically |
| 32 | Section 1350 Certification | Filed Electronically |

Digi International Inc.
2000 Omnibus Stock Plan
as Amended and Restated as of
November 27, 2006

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

2. Definitions.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(A) on the composite tape for NASDAQ-listed shares, or

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

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

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

In the case of an Incentive Stock Option, if this determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury, Fair Market Value shall be determined in accordance with those regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Plan Section 16.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3. Administration and Indemnification.

3.1 Administration.

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

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

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

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

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

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

4. Shares Available Under the Plan.

(a) The number of Shares available for distribution under the Plan shall not exceed 3,250,000 (subject to adjustment pursuant to Plan Section 16).

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

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

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

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

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

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

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

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

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

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

5. Eligibility. Participation in the Plan shall be limited to Employees and to individuals or entities who are not Employees but who provide services to the Company or an Affiliate, including services provided in the capacity of a consultant, advisor or director. The granting of Awards is solely at the discretion of the Committee, except that Incentive Stock Options may only be granted to Employees. References herein to “employed,” “employment” or similar terms (except “Employee”) shall include the providing of services in any capacity or as a director. Neither the transfer of employment of a Participant between any of the Company or its Affiliates, nor a leave of absence granted to such Participant and approved by the Committee, shall be deemed a termination of employment for purposes of the Plan.

6. General Terms of Awards.

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

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

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

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

(a) Options and Stock Appreciation Rights.

- (i) If a Participant's employment or other relationship with the Company and its Affiliates terminates because of the Participant's death, then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and a date not more than three months prior to such death, and may be exercised by the Participant's Successor at any time, or from time to time, within one year after the date of the Participant's death.
- (ii) If a Participant's employment or other relationship with the Company and its Affiliates terminates because the Participant is disabled (within the meaning of Section 22(e)(3) of the Code), then any Option or Stock Appreciation Right that has not expired or been terminated shall become exercisable in full if the Participant's employment or other relationship with the Company and its Affiliates has been continuous between the date the Option or Stock Appreciation Right was granted and the date of such disability, and the Participant or the Participant's Successor may exercise such Option or Stock Appreciation Right at any time, or from time to time, within one year after the date of the Participant's disability.
- (iii) If a Participant's employment terminates for any reason other than death or disability, then any Option or Stock Appreciation Right that has not expired or been terminated shall remain exercisable for three months after termination of the Participant's employment, but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Participant's termination of employment; provided, however, that if the Participant is an Outside Director, the Option or Stock Appreciation Right shall remain exercisable until the expiration of the Term after such Outside Director ceases to be a director of the Company but, unless otherwise provided in the Agreement, only to the extent that such Option or Stock Appreciation Right was exercisable immediately prior to such Outside Director ceasing to be a director.

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

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

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

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

7. Restricted Stock Awards.

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

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

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

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

(e) No more than 1,000,000 of the total number of Shares available for Awards under the Plan shall be issued during the term of the Plan as Restricted Stock. This limitation shall be calculated pursuant to the applicable provisions of Plan Sections 4 and 16.

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

9. Stock Options.

9.1 Terms of All Options.

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

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

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

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

(i) the purchase price of each Share subject to an Incentive Stock Option shall not be less than 100% of the Fair Market Value of a Share as of the date the Incentive Stock Option is granted if this limitation is necessary to qualify the Option as an Incentive Stock Option (except as provided in Plan Section 20);

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

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

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

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

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

11. Performance Units.

11.1 Initial Award.

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

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

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

12. Effective Date and Duration of the Plan.

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

12.2 Duration of the Plan. The Plan shall remain in effect until all Stock subject to it shall be distributed, all Awards have expired or lapsed, the Plan is terminated pursuant to Plan Section 15, or November 27, 2016 (the "Termination Date"); provided, however, that Awards made before the Termination Date may be exercised, vested or otherwise effectuated beyond the Termination Date unless limited in the Agreement or otherwise. No Award of an Incentive Stock Option shall be made more than 10 years after the Effective Date (or such other limit as may be required by the Code) if this limitation is necessary to qualify the Option as an Incentive Stock Option. The date and time of approval by the Committee of the granting of an Award shall be considered the date and time at which the Award is made or granted.

13. Plan Does Not Affect Employment Status.

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

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

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

15. Amendment, Modification and Termination of the Plan.

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

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

16. Adjustment for Changes in Capitalization. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to (i) the number and kind of Shares that may be issued under the Plan, (ii) the limitations on the number of Shares that may be issued to an individual Participant as an Option or a Stock Appreciation Right in any calendar year or that may be issued in the form of Restricted Stock or Shares without restrictions and (iii) the number and kind of Shares or, subject to Plan Section 11.2, Performance Units, subject to and the exercise price (if applicable) of any then outstanding Awards of Options, Stock Appreciation Rights, Restricted Stock, Performance Units or any other Awards related to shares of Stock (to the extent such other Awards would not otherwise automatically adjust in the equity restructuring); provided, in each case, that with respect to Incentive Stock Options, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; provided further, with respect to all Awards, no such adjustment shall be authorized to the extent that such adjustment would cause the Awards to be subject to adverse tax consequences under Section 409A of the Code. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such

reorganization comes within the definition of such term in Section 368 of the Code), including a Fundamental Change (subject to Plan Section 17), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan. Unless otherwise determined by the Committee, the number of Shares subject to an Award shall always be a whole number. In no event shall an outstanding Option or Stock Appreciation Right be amended for the sole purpose of reducing the exercise price or grant price thereof.

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

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

(b) at least ten days before the occurrence of the Fundamental Change, declare, and provide written notice to each holder of an Option or Stock Appreciation Right of the declaration, that each outstanding Option and Stock Appreciation Right, whether or not then exercisable, shall be canceled at the time of, or immediately before the occurrence of the Fundamental Change in exchange for payment to each holder of an Option or Stock Appreciation Right, within ten days after the Fundamental Change, of cash equal to (i) for each Share covered by the canceled Option, the amount, if any, by which the Fair Market Value (as defined in this Section) per Share exceeds the exercise price per Share covered by such Option or (ii) for each Stock Appreciation Right, the price determined pursuant to Section 10, except that Fair Market Value of the Shares as of the date of exercise of the Stock Appreciation Right, as used in clause (i) of Plan Section 10, shall be deemed to mean Fair Market Value for each Share with respect to which the Stock Appreciation Right is calculated determined in the manner hereinafter referred to in this Section. At the time of the declaration provided for in the immediately preceding sentence, each Stock Appreciation Right and each Option shall immediately become exercisable in full and each person holding an Option or a Stock Appreciation Right shall have the right, during the period preceding the time of cancellation of the Option or Stock Appreciation Right, to exercise the Option as to all or any part of the Shares covered thereby or the Stock Appreciation Right in whole or in part, as the case may be. In the event of a declaration pursuant to Plan Section 17(b), each outstanding Option and Stock Appreciation Right granted pursuant to the Plan that shall not have been exercised before the Fundamental Change shall be canceled at the time of, or immediately before, the Fundamental Change, as provided in the declaration. Notwithstanding the foregoing, no person holding an Option or a Stock Appreciation Right shall be entitled to the payment provided for in this Section 17(b) if such Option or Stock Appreciation Right shall have terminated, expired or been cancelled. For purposes of this Section only, "Fair Market Value" per Share means the cash plus the fair market value, as determined in good faith by the Committee, of the non-cash consideration to be received per Share by the stockholders of the Company upon the occurrence of the Fundamental Change.

18. Prohibition on Repricing. Without the approval of the Company's stockholders, the Committee will not reprice, adjust or amend the exercise price of any Option or the grant price of any Stock Appreciation Right previously awarded, whether through amendment, cancellation and replacement grant or any other means, except pursuant to Section 16 of the Plan in connection with an equity restructuring, or pursuant to Section 17 of the Plan in connection with a Fundamental Change, in order to prevent dilution or enlargement of the benefits, or potential benefits intended to be provided under the Plan.

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

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

21. Unfunded Plan. The Plan shall be unfunded and the Company shall not be required to segregate any assets that may at any time be represented by Awards under the Plan. Neither the Company, its Affiliates, the Committee, nor the Board of Directors shall be deemed to be a trustee of any amounts to be paid under the Plan nor shall anything contained in the Plan or any action taken pursuant to its provisions create or be construed to create a fiduciary relationship between the Company and/or its Affiliates, and a Participant or Successor or Transferee. To the extent any person acquires a right to receive an Award under the Plan, this right shall be no greater than the right of an unsecured general creditor of the Company.

22. Limits of Liability.

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

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

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

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

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

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

27. Requirements of Law.

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

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

**DIGI INTERNATIONAL INC.
EMPLOYEE STOCK PURCHASE PLAN
AS AMENDED AND RESTATED AS OF NOVEMBER 27, 2006**

1. **PURPOSE AND SCOPE OF PLAN.** The purpose of this Digi International Inc. Employee Stock Purchase Plan (the “Plan”) is to provide the employees of Digi International Inc. (the “Company”) with an opportunity to acquire a proprietary interest in the Company through the purchase of its Common Stock and, thus, to develop a stronger incentive to work for the continued success of the Company. The Plan is intended to be an “employee stock purchase plan” within the meaning of Section 423(b) of the Internal Revenue Code of 1986, as amended, and shall be interpreted and administered in a manner consistent with such intent.

2. **DEFINITIONS.**

2.1. The terms defined in this section are used (and capitalized) elsewhere in this Plan:

(a) “Affiliate” means any corporation that is a “parent corporation” or “subsidiary corporation” of the Company, as defined in Sections 424(e) and 424(f) of the Code or any successor provision, and whose participation in the Plan has been approved by the Board of Directors.

(b) “Board of Directors” means the Board of Directors of the Company.

(c) “Code” means the Internal Revenue Code of 1986, as amended from time to time.

(d) “Committee” means three or more Disinterested Persons designated by the Board of Directors to administer the Plan under Section 13.

(e) “Common Stock” means the common stock, par value \$.01 per share (as such par value may be adjusted from time to time), of the Company.

(f) “Company” means Digi International Inc.

(g) “Compensation” means the gross cash compensation (including wage, salary, commission, bonus, and overtime earnings) paid by the Company or any Affiliate to a Participant in accordance with the terms of employment.

(h) “Disinterested Persons” means a member of the Board of Directors who is considered a disinterested person within the meaning of Exchange Act Rule 16b-3 or any successor definition.

(i) "Eligible Employee" means any employee of the Company or an Affiliate who has been employed for at least 90 days and whose customary employment is at least 20 hours per week; provided, however, that "Eligible Employee" shall not include any person who would be deemed for purposes of Section 423(b)(3) of the Code, to own stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company.

(j) "Exchange Act" means the Securities Exchange Act of 1934, as amended from time to time.

(k) "Fair Market Value" of a share of Common Stock as of any date means, if the Company's Common Stock is listed on a national securities exchange or traded in the national market system, the mean between the high and low sale prices for such Common Stock on such exchange or market on said date, or, if no sale has been made on such exchange or market on said date, on the last preceding day on which any sale shall have been made. If such determination of Fair Market Value is not consistent with the then current regulations of the Secretary of the Treasury applicable to plans intended to qualify as an "employee stock purchase plan" within the meaning of Section 423(b) of the Code, however, Fair Market Value shall be determined in accordance with such regulations. The determination of Fair Market Value shall be subject to adjustment as provided in Section 14.

(l) "Participant" means an Eligible Employee who has elected to participate in the Plan in the manner set forth in Section 4.

(m) "Plan" means this Digi International Inc. Employee Stock Purchase Plan, as amended from time to time.

(n) "Purchase Period" means each quarter of the Company's fiscal year. The first Purchase Period will be the quarter that starts April 1, 1996 and ends June 30, 1996.

(o) "Recordkeeping Account" means the account maintained in the books and records of the Company recording the amount withheld from each Participant through payroll deductions made under the Plan.

(p) "Share" means a share of Common Stock.

3. SCOPE OF THE PLAN. Shares of Common Stock may be sold by the Company to Eligible Employees commencing April 1, 1996, as hereinafter provided, but not more than 1,750,000 shares of Common Stock (subject to adjustment as provided in Section 14) shall be sold to Eligible Employees pursuant to this Plan. All sales of Common Stock pursuant to this Plan shall be subject to the same terms, conditions, rights and privileges. The shares of Common Stock delivered by the Company pursuant to this Plan may be acquired shares having the status of any combination of authorized but unissued shares, newly issued shares, or treasury shares.

4. **ELIGIBILITY AND PARTICIPATION.** To be eligible to participate in the Plan for a given Purchase Period, an employee must be an Eligible Employee on the first day of such Purchase Period. An Eligible Employee may elect to participate in the Plan by filing an enrollment form with the Company before the first day of such Purchase Period that authorizes regular payroll deductions from Compensation beginning with the first payday in such Purchase Period and continuing until the Eligible Employee withdraws from the Plan, modifies his or her authorization, or ceases to be an Eligible Employee, as hereinafter provided.

5. **AMOUNT OF COMMON STOCK EACH ELIGIBLE EMPLOYEE MAY PURCHASE.**

5.1. Subject to the provisions of the Plan, each Eligible Employee shall be offered the right to purchase on the last day of the Purchase Period the number of shares of Common Stock (including fractional shares) that can be purchased at the price specified in Section 5.2 with the entire credit balance in the Participant's Recordkeeping Account; provided, however, that the Fair Market Value (determined on the first day of any Purchase Period) of shares of Common Stock that may be purchased by a Participant during such Purchase Period shall not exceed the excess, if any, of (i) \$25,000 over (ii) the Fair Market Value (determined on the first day of the relevant Purchase Period) of shares of Common Stock previously acquired by the Participant in any prior Purchase Period during such calendar year. Notwithstanding the foregoing, no Eligible Employee shall be granted an option to acquire shares of Common Stock under this Plan which permits the Eligible Employee's rights to purchase shares of Common Stock under this Plan and all employee stock purchase plans of the Company and the Affiliates to accrue at a rate which exceeds \$25,000 of Fair Market Value (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. If the purchases by all Participants would otherwise cause the aggregate number of shares of Common Stock to be sold under the Plan to exceed the number specified in Section 3, however, each Participant shall be allocated at a ratable portion of the maximum number of shares of Common Stock which may be sold.

5.2. The purchase price of each share of Common Stock sold pursuant to this Plan will be the lesser of (a) or (b) below: (a) 85% of the Fair Market Value of such share on the first day of the Purchase Period. (b) 85% of the Fair Market Value of such share on the last day of the Purchase Period.

6. **METHOD OF PARTICIPATION.**

6.1. The Company shall give notice to each Eligible Employee of the opportunity to purchase shares of Common Stock pursuant to this Plan and the terms and conditions for such offering. Such notice is subject to revision by the Company at any time prior to the date of purchase of such shares. The Company contemplates that for tax purposes the first day of a Purchase Period will be the date of the offering of such shares.

6.2. Each Eligible Employee who desires to participate in the Plan for a Purchase Period shall signify his or her election to do so by signing an election form developed by the Committee. An Eligible Employee may elect to have any whole percent of Compensation withheld, but not exceeding ten percent (10%) per pay period. An election to participate in the Plan and to authorize payroll deductions as described herein must be made before the first day of the Purchase Period to which it relates and shall remain in effect unless and until such Participant withdraws from this Plan, modifies his or her authorization, or terminates his or her employment with the Company, as hereinafter provided.

6.3. Any Eligible Employee who does not make a timely election as provided in Section 6.2, shall be deemed to have elected not to participate in the Plan. Such election shall be irrevocable for such Purchase Period.

7. RECORDKEEPING ACCOUNT.

7.1. The Company shall maintain a Recordkeeping Account for each Participant. Payroll deductions pursuant to Section 6 will be credited to such Recordkeeping Accounts on each payday.

7.2. No interest will be credited to a Participant's Recordkeeping Account.

7.3. The Recordkeeping Account is established solely for accounting purposes, and all amounts credited to the Recordkeeping Account will remain part of the general assets of the Company.

7.4. A Participant may not make any separate cash payment into the Recordkeeping Account.

8. RIGHT TO ADJUST PARTICIPATION OR TO WITHDRAW.

8.1. A Participant may, at any time during a Purchase Period, direct the Company to make no further deductions from his or her Compensation or to adjust the amount of such deductions. Upon either of such actions, future payroll deductions with respect to such Participant shall cease or be adjusted in accordance with the Participant's direction.

8.2. Any Participant who stops payroll deductions may not thereafter resume payroll deductions during such Purchase Period.

8.3. At any time before the end of a Purchase Period, any Participant may also withdraw from the Plan. In such event, all future payroll deductions shall cease and the entire credit balance in the Participant's Recordkeeping Account will be paid to the Participant, without interest, in cash within 15 days. A Participant who withdraws from the Plan will not be eligible to reenter the Plan until the next succeeding Purchase Period.

8.4. Notification of a Participant's election to adjust or terminate deductions, or to withdraw from the Plan, shall be made by the filing of an appropriate notice to such effect with the Company.

9. TERMINATION OF EMPLOYMENT. If the employment of a Participant is terminated for any reason, including death, disability, or retirement, the entire balance in the Participant's Recordkeeping Account will be applied to the purchase of shares as provided in Section 10.1 as of the last day of the Purchase Period in which the Participant's employment terminated; except that if such Participant so requests prior to the last day of such Purchase Period, the Company shall refund in cash within 15 days all amounts credited to his or her Recordkeeping Account.

10. PURCHASE OF SHARES.

10.1. As of the last day of the Purchase Period, the entire credit balance in each Participant's Recordkeeping Account will be used to purchase shares (including fractional shares) of Common Stock (subject to the limitations of Section 5) unless the Participant has filed an appropriate form with the Company in advance of that date (which either elects to purchase a specified number of shares which is less than the number described above or elects to receive the entire credit balance in cash). Any amount in a Participant's Recordkeeping Account that is not used to purchase shares pursuant to this Section 10.1 will be refunded to the Participant.

10.2. Shares of Common Stock acquired by each Participant shall be held in a general account maintained for the benefit of all Participants.

10.3. Certificates for the number of whole shares of Common Stock, determined as aforesaid, purchased by each Participant shall be issued and delivered to him or her only upon request of the Participant or his or her representative directed to the Company. No Certificates for fractional shares will be issued. Instead, Participants will receive a cash distribution representing any fractional shares.

10.4. Dividends with respect to a Participant's shares held in the general account will, at the election of the Participant, either be paid to the Participant in cash or reinvested in additional shares of Common Stock. If a Participant fails to make such an election, all dividends with respect to the Participant's shares held in the general account will automatically be reinvested to purchase additional shares of Common Stock.

10.5. Each Participant will be entitled to vote all shares held for the benefit of such Participant in the general account.

11. RIGHTS AS A STOCKHOLDER. A Participant shall not be entitled to any of the rights or privileges of a stockholder of the Company with respect to such shares, including the right to receive any dividends which may be declared by the Company, until (i) he or she actually has paid the purchase price for such shares and (ii) either the shares have been credited to his or her account or certificates have been issued to him or her, both as provided in Section 10.

12. RIGHTS NOT TRANSFERABLE. A Participant's rights under this Plan are exercisable only by the Participant during his or her lifetime, and may not be sold, pledged, assigned or transferred in any manner other than by will or the laws of descent and distribution. Any attempt to sell, pledge, assign or transfer the same shall be null and void and without effect. The amounts credited to a Recordkeeping Account may not be assigned, transferred, pledged or hypothecated in any way, and any attempted assignment, transfer, pledge, hypothecation or other disposition of such amounts will be null and void and without effect.

13. ADMINISTRATION OF THE PLAN. This Plan shall be administered by the Committee, which is authorized to make such uniform rules as may be necessary to carry out its provisions. The Committee shall determine any questions arising in the administration, interpretation and application of this Plan, and all such determinations shall be conclusive and binding on all parties.

14. ADJUSTMENT FOR CHANGES IN CAPITALIZATION. In the event of any equity restructuring (within the meaning of Financial Accounting Standards No. 123 (revised 2004)) that causes the per Share value of Shares to change, such as a stock dividend, stock split, spin off, rights offering, or recapitalization through a large, nonrecurring cash dividend, the Committee shall cause there to be made an equitable adjustment to the number, class and purchase price of Shares that may be purchased under the Plan. In the event of any other change in corporate capitalization, such as a merger, consolidation, any reorganization (whether or not such reorganization comes within the definition of such term in Section 368 of the Code), or any partial or complete liquidation of the Company, such equitable adjustments described in the foregoing sentence may be made as determined to be appropriate and equitable by the Committee to prevent dilution or enlargement of rights. In either case, any such adjustment shall be conclusive and binding for all purposes of the Plan.

15. REGISTRATION OF CERTIFICATES. Stock certificates will be registered in the name of the Participant, or jointly in the name of the Participant and another person, as the Participant may direct on an appropriate form.

16. AMENDMENT OF PLAN. The Board of Directors may at any time amend this Plan in any respect which shall not adversely affect the rights of Participants pursuant to shares previously acquired under the Plan, except that, without stockholder approval, no amendment shall be made (i) to increase the number of shares to be reserved under this Plan, (ii) to decrease the minimum purchase price, (iii) to withdraw the administration of this Plan from the Committee, or (iv) to change the definition of employees eligible to participate in the Plan.

17. EFFECTIVE DATE OF PLAN. This Plan shall consist of an offering commencing April 1, 1996, and ending June 30, 1996, and continuing on a quarterly basis thereafter. All rights of Participants in any offering hereunder shall terminate at the earlier of (i) the day that Participants become entitled to purchase a number of shares of Common Stock equal to or greater than the number of shares remaining available for purchase or (ii) at any time, at the discretion of the Board of Directors, after 30 days' notice has been given to all Participants. Upon termination of this Plan, shares of Common Stock shall be issued to Participants in accordance with Section 10, and cash, if any, remaining in the Participant's Recordkeeping Accounts shall be refunded to them, as if the Plan were terminated at the end of a Purchase Period.

18. **GOVERNMENTAL REGULATIONS AND LISTING.** All rights granted or to be granted to Eligible Employees under this Plan are expressly subject to all applicable laws and regulations and to the approval of all governmental authorities required in connection with the authorization, issuance, sale or transfer of the shares of Common Stock reserved for this Plan, including, without limitation, there being a current registration statement of the Company under the Securities Act of 1933, as amended, covering the shares of Common Stock purchasable on the last day of the Purchase Period applicable to such shares, and if such a registration statement shall not then be effective, the term of such Purchase Period shall be extended until the first business day after the effective date of such a registration statement, or post-effective amendment thereto. If applicable, all such rights hereunder are also similarly subject to effectiveness of an appropriate listing application to a national securities exchange or a national market system, covering the shares of Common Stock under the Plan upon official notice of issuance.

19. **MISCELLANEOUS.**

19.1. This Plan shall not be deemed to constitute a contract of employment between the Company and any Participant, nor shall it interfere with the right of the Company to terminate any Participant and treat him or her without regard to the effect which such treatment might have upon him or her under this Plan.

19.2. Wherever appropriate as used herein, the masculine gender may be read as the feminine gender, the feminine gender may be read as the masculine gender, the singular may be read as the plural and the plural may be read as the singular.

19.3. The Plan, and all agreements hereunder, shall be construed in accordance with and governed by the laws of the State of Minnesota.

19.4. Delivery of shares of Common Stock or of cash pursuant to this Plan shall be subject to any required withholding taxes. A person entitled to receive shares of Common Stock may, as a condition precedent to receiving such shares, be required to pay the Company a cash amount equal to the amount of any required withholdings.

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

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

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

February 7, 2007

/s/ Joseph T. Dunsmore

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

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

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

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

February 7, 2007

/s/Subramanian Krishnan

Subramanian Krishnan

Senior Vice President, Chief Financial Officer and Treasurer

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

In connection with the Quarterly Report of Digi International Inc. (the Registrant) on Form 10-Q for the fiscal quarter ending December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

February 7, 2007

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

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